(34,002, 34,003)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1928

No. 693

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, ET AL., PETITIONERS,

vs.

JOHN C. BARCLAY AND WILLOUGHBY COMPANY

No. 694

SHIRLEY P. AUSTIN, PETITIONER,

vs.

JOHN C. BARCLAY AND WILLOUGHBY COMPANY

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

In Equity. No. E 43-298

JOHN C. BARCLAY, Plaintiff,

against

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, LAMOTTE T. COHU, GERALD V. HOLLINS, SHIRLEY P. AUSTIN, GEORGE R. LESLIE, AND EARL KRAPP, Defendants

BILL OF COMPLAINT

Plaintiff, John C. Barclay, on his own behalf and on behalf of all holders of the Five Per Cent Profit Sharing Preferred Stock A of defendant Wabash Railway Company, who may hereafter join in the prosecution of this suit, brings this his Bill of Complaint against said Wabash Railway Company, Myron S. Hall, H. W. Cohu, LaMotte T. Cohu, Gerald V. Hollins, Shirley P. Austin, George R. Leslie and Earl Krapp, and alleges:

First. Plaintiff, John C. Barclay, is a citizen and resident of the State of New Jersey, residing at Montclair in said State. Defendant, Wabash Railway Company (hereinafter called the "Railway Company"), is a corporation duly or-
[fol. 2] ganized and existing under the laws of the State of Indiana, and is a citizen and resident of said State and having an office at 120 Broadway, New York City, New York. Defendants, Myron S. Hall, H. W. Cohu and LaMotte T. Cohu are citizens and residents of the City and State of New York. Defendants Gerald V. Hollins and George R. Leslie are citizens and residents of the State of New York, the former residing at East Islip and the latter at Syosset in said State. Defendant, Shirley P. Austin, is a citizen and resident of the Commonwealth of Pennsylvania, residing at Pittsburgh in said Commonwealth. Defendant, Earl Krapp, is a citizen and resident of the State

of New York, residing in New York City in said State. Defendants, Myron S. Hall, H. W. Cohu and LaMotte T. Cohu, are co-partners doing business under the firm name and style of Myron S. Hall & Co., having their principal office at 100 Broadway, New York City, New York. Defendants, Gerald V. Hollins, Shirley P. Austin and George R. Leslie, are co-partners doing business under the firm name and style of C. D. Halsey and Co., having their principal office at 27 William Street, New York City, New York.

Second This is a suit of a civil nature in equity and the matter in controversy herein exceeds, exclusive of interest and costs, the sum of value of $5,000.

Third. The Railway Company owns, possesses, controls and operates a railway system lying within the States of Ohio, Illinois, Indiana, Iowa and Missouri. It was duly organized under the laws of Indiana on or about October 22, 1915. A copy of its Certificate of Incorporation is [fol. 3] hereto annexed, marked Exhibit A, and made a part hereof.

Fourth. As appears by Article "Third" of said Certificate of Incorporation, the original capital stock of the Railway Company consisted of 1,434,600 shares, each of the par value of $100, classified as follows:

462,000 shares, each of the par value of $100, of Five Per Cent Profit Sharing Preferred Stock A.

499,700 shares, each of the par value of $100, of Five Per Cent Convertible Preferred Stock B.

472,900 shares, each of the par value of $100, of Common Stock.

Said Five Per Cent Convertible Preferred Stock B (hereinafter called "Preferred Stock B") was by its terms convertible into said Five Per Cent Profit Sharing Preferred A (hereinafter called "Preferred Stock A") and said Common Stock of the Railway Company at the rate of one-half share of said Preferred Stock A and one-half share of said Common Stock for each share of Preferred Stock B of the Railway Company. By reason of conversion of Preferred Stock B pursuant to the conversion privilege inhering therein as aforesaid and for other reasons unknown

to plaintiff the number of shares of the several classes of stock of the Railway Company outstanding on May 1, 1927, and now outstanding was as follows:

693,330.50 shares, each of the par value of $100, of said Preferred Stock A.

24,211.42 shares, each of the par value of $100, of said Preferred Stock B.

[fol. 4] 666,977.75 shares, each of the par value of $100, of said Common Stock.

Fifth. Plaintiff is and for several years last past has been the owner and holder of 100 shares, each of the par value of $100, of said Preferred Stock A of the Railway Company. Defendants, Myron S. Hall, H. W. Cohu and LaMotte T. Cohu, as such copartners, are the owners and holders of 2,197 shares, each of the par value of $100, of said Preferred Stock B of the Railway Company. Defendants, Gerald V. Hollins, Shirley P. Austin and George R. Leslie, as such co-partners, are the owners and holders of 15,505 shares, each of the par value of $100, of said Common Stock of the Railway Company, and defendant, Earl Krapp, is the holder and owner of 2,500 shares of such Common Stock.

Sixth. The owners and holders of said Preferred Stock B and of the said Common Stock of the Railway Company are numerous and widely scattered, and many of them are unknown to plaintiff. Said Myron S. Hall, H. W. Cohu and LaMotte T. Cohu have been made parties defendant hereto as representatives of the holders of the Preferred Stock B and said Gerald V. Hollins, Shirley P. Austin, George R. Leslie and Earl Krapp have been made parties defendant hereto as representatives of the holders of the Common Stock of the Railway Company.

Seventh. The respective rights of the three classes of stock of the Railway Company to dividends are set forth in Article Fourth of the Certificate of Incorporation, hereto annexed as Exhibit A, and also in the certificates issued by the Railway Company for said several classes of its stock. A copy of the certificate issued by the Railway Company [fol. 5] for said Preferred Stock A is hereto annexed, marked Exhibit B, and made a part hereof. The right of

said Preferred Stock A to dividends is set forth in the Certificate of Incorporation in the following language:

"The Five Per Cent. Profit Sharing Preferred Stock A shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. before any dividends shall be paid upon any other stock of this corporation, but such dividends on the Five Per Cent. Profit Sharing Preferred A Stock shall be non-cumulative."

The right of the Preferred A Stock to dividends is set forth in the certificates representing such stock in the following language:

"The holders of the Five Per Cent. Profit Sharing Preferred Stock A of the Company shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. before any dividends shall be paid upon any other stock of the Company, but such preferential dividends shall be non-cumulative."

Eighth. In every fiscal year since the organization of the Railway Company in October, 1915, down to and including 1926, the Railway Company has had large net earnings available for dividends on its said Preferred Stock A. No dividends were declared or paid by the Railway Company upon its said Preferred Stock A during the period from the organization of the Railway Company until January 29, 1917, although during said period the Railway Company had net earnings in large amounts available for dividends on such stock. On January 29, 1917, the Railway Company paid a dividend of 1% upon its said Pre- [fol. 6] ferred Stock A, and paid a like dividend of 1% thereon quarterly thereafter, up to and including April 30, 1918. During said period from January 29, 1917, up to and including April 30, 1918, the Railway Company had net earnings in each fiscal year available for dividends on its said Preferred Stock A more than sufficient to pay the full preferential dividend of 5% in each fiscal year on said Preferred Stock A. During the period from and after April 30, 1918, to May 25, 1925, no dividends were paid upon said Preferred Stock A, although during said period the Railway Company in each fiscal year had net earnings available

for dividends on said Preferred Stock A sufficient to pay dividends in large amounts in each fiscal year upon such stock. On May 25, 1925 the Railway Company paid a quarterly dividend of 1¼% upon its said Preferred Stock A and has thereafter paid a quarterly dividend of like amount down to the date hereof, such amount representing dividends of 5% in each fiscal year since May 25, 1925, upon said Preferred Stock A.

Ninth. The earnings of each fiscal year available for dividends on said Preferred Stock A of the Railway Company in each year in which the Company declared no dividends or declared dividends of less than 5% on said Preferred Stock A, were retained by the Railway Company and carried to its surplus account and used for additional working capital and for other purposes.

Tenth. During the period from the organization of the Railway Company to May 25, 1925, the aggregate of the preferential dividends of 5% in each fiscal year upon said Preferred Stock A of the Railway Company, to the extent that the Railway Company had in each fiscal year during [fol. 7] said period net earnings available for the payment of such dividends, amounted to more than $16,000,000 in excess of the dividends declared and paid by the Railway Company upon said Preferred Stock A during said period and all of said sum of $16,000,000 available for such dividends, but unpaid therefor, was carried to the surplus of the Railway Company and used for additional working capital and for other proper corporate purposes.

Eleventh. The Railway Company paid no dividends upon its said Preferred Stock B from the organization of the Railway Company until April 1, 1927. On April 1, 1927, the Railway Company paid a dividend of 5% upon its said Preferred Stock B, but has paid no dividends thereon since April 1, 1927. The Railway Company has heretofore paid no dividends on its said Common Stock.

Twelfth. The Railway Company since May 1, 1925, has in each fiscal year had net earnings available for dividends on its capital stock in amounts more than sufficient to pay in full the preferential 5% dividend on its said Preferred Stock A. The Railway Company is now in such financial

condition that it no longer needs to retain as surplus, its net earnings in prior fiscal years which were available for preferential dividends on its said Preferred Stock A unpaid in such prior fiscal years. Plaintiff is informed and believes that the Railway Company threatens to and will, unless restrained by this Honorable Court, at once inaugurate the payment of regular dividends upon its said Preferred Stock B and upon its Common Stock, and threatens to and will pay such dividends out of its earnings or surplus, without [fol. 8] first having made good and paid out of such surplus full preferential dividends of 5% in each fiscal year upon its Preferred Stock A from the time of the organization of the Company down to the date hereof, to the extent that such preferential dividends were earned in each fiscal year but were not paid in full, thereby depriving the holders of its said Preferred Stock A of the dividend rights inhering in said Preferred Stock A and diverting from said Preferred Stock A net earnings available for said preferential dividends thereon which were not paid.

Thirteenth. The Railway Company claimed the right to pay the dividends above mentioned on its said Preferred Stock B and claims the right and threatens to pay future dividends thereon and to pay dividends on its said Common Stock in each fiscal year out of its net earnings in such fiscal year, remaining after the payment in such fiscal year of the preferential dividends on its said Preferred Stock A, without having first declared and paid on its said Preferred Stock A the unpaid preferential dividends on such Preferred Stock A for prior fiscal year in which the Railway Company had net earnings available for the payment of such unpaid preferential dividends.

Fourteenth. Under the contract between the Railway Company, the holders of said Preferred Stock A and the holders of the other classes of stock of the Railway Company, the holders of said Preferred Stock A are entitled to receive preferential dividends in each fiscal year up to the amount of 5% to the extent that the Railway Company has earnings in such fiscal year available for such dividends, before any dividends may be paid upon any other stock of [fol. 9] the Company and are entitled to receive such preferential dividends in full in each fiscal year to the extent

that the Railway Company has net earnings in such year available for the payment of such dividends, before any dividends may be paid on any other class of stock of the Railway Company, and, to the extent that such preferential dividends have been earned but not paid by the Railway Company, the holders of said Preferred Stock A are entitled to receive such earned but unpaid preferential dividends, before any dividends may be declared or paid by the defendant Railway Company to the holders of stock of any other class.

Fifteenth. The Railway Company is without legal right under its Certificate of Incorporation to declare or pay any dividends upon any class of its stock other than its said Preferred Stock A until after all the earned but unpaid preferential dividends for each fiscal year up to the full amount of 5% upon such Preferred Stock A shall have been paid to the holders of such stock. The Railway Company had and has no legal right to declare or pay said dividends above mentioned or any dividends upon its said Preferred Stock B or to declare or pay any dividends upon its said Common Stock, and said payments were and will be in violation of plaintiff's contract with the Railway Company and the holders of its stock of other classes.

Sixteenth. Plaintiff has no adequate remedy at law and can have relief only in court equity. Plaintiff therefore files this his Bill of Complaint and prays for relief as follows:

1. That the rights of plaintiff and of all other holders of [fol. 10] the Preferred Stock A of the Railway Company and of the holders of the Preferred Stock B of the Railway Company and of the Common Stock of the Railway Company in and to dividends from the net earnings of the Railway Company available for dividends upon its capital stock be determined.

2. That this Honorable Court decree that the holders of said Preferred Stock A of the Railway Company are entitled to receive preferential dividends up to the amount of 5% for each fiscal year from 1915 to 1926 inclusive to the extent that such dividends were earned in such fiscal years but were unpaid, but not in excess of 5% for any fiscal year, before any dividends be paid by the Railway Company upon any other class of its stock.

3. That the Railway Company be enjoined and restrained from declaring or paying any further dividends upon its said Preferred Stock B or any dividends upon its Common Stock, until after all the preferential dividends at the rate of 5% in each fiscal year upon its said Preferred Stock A from the date of the organization of said Company down to and including the fiscal year 1926, to the extent that the Railway Company has had net earnings available for the payment of such dividends and to the extent that such dividends remain unpaid, shall have been paid to the holders of said Preferred Stock A.

4. That an interlocutory injunction issue out of and under the seal of the Court, enjoining and restraining the Railway Company temporarily and pending the determination of this suit from declaring or paying any dividends upon its said Preferred Stock B or any dividends upon its Common Stock, unless it shall first have paid all the preferential [fol. 11] dividends at the rate of 5% in each fiscal year from the date of the organization of the Railway Company down to and including the fiscal year 1926, to the extent that the Railway Company has had net earnings available for the payment of such dividends and to the extent that such dividends remain unpaid.

5. That plaintiff have such other and further relief as may be meet and just in the premises.

Wm. R. Begg, Solicitor for Plaintiff. Office & P. O. Address: 24 Broad Street, Borough of Manhattan, New York City. Hornblower, Miller & Garrison, of Counsel.

Duly sworn to by John C. Barclay. Jurat omitted in printing.

[fol. 12] EXHIBIT A TO BILL OF COMPLAINT

Know all men by these presents that we, the undersigned, whose names are hereunto subscribed, being the purchasers at the sale hereinaftr mentioned and the associates of such purchasers, do hereby certify that, under and in pursuance of an Act of the General Assembly of the State of Indiana

approved March 3, 1865, entitled "An Act to authorize, regulate and confirm the sale of railroads, to enable purchasers of the same to form corporations and to exercise corporate powers, and to define their rights, powers and privileges; to enable such corporations to purchase and construct connecting and branch roads, and to operate and maintain the same," and any and all supplements thereof and amendments thereto, we have formed a corporation for the purpose of acquiring, owning, maintaining and operating the railroad, property and franchises sold at said sale and hereinafter described; and we do further specify and certify as follows:

First. The name and style of this corporation shall be Wabash Railway Company.

Second. The number of directors of this corporation shall be fifteen, and the names of the first directors are as follows: Samuel Armstrong, H. Brua Campbell, Robert Goelet, Lawrence Greer, Edward F. Kearney, William C. Maxwell, George Welwood Murray, Robert H. Neilson, John [fol. 13] C. Otteson, Winslow S. Pierce, Lyman Rhoades, Allison E. Stuart, William V. Stuart, James E. Taussig, and Henry Rogers Winthrop. The period of the service of the first directors shall be from the filing of this certificate in the office of the Secretary of State of the State of Indiana until the second Tuesday in October, 1916. Vacancies occurring in the first board of directors, or any subsequent board, through death, resignation or otherwise, may be filled, until the next annual election of directors by the stockholders, by the vote of a majority of the whole board of directors.

Third. The amount of the original capital of this corporation is One Hundred and Forty-three Million, Four Hundred and Sixty Thousand Dollars ($143,460,000), and the number of shares into which said capital is to be divided is one million, four hundred and thirty-four thousand, six hundred (1,434,600) shares of the par value of One Hundred Dollars ($100) each. Of such capital stock four hundred and sixty-two thousand (462,000) shares shall be issued as Five Per Cent. Profit Sharing Preferred Stock A, four hundred and ninety-nine thousand, seven hundred (499,700) shares shall be issued as Five Per Cent. Con-

vertible Preferred Stock B, and four hundred and seventy-two thousand, nine hundred (472,900) shares shall be issued as Common Stock.

Fourth. The Five Per Cent. Profit Sharing Preferred [fol. 14] Stock A shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. before any dividends shall be paid upon any other stock of this corporation, but such dividends on the Five Per Cent. Profit Sharing Preferred Stock A shall be noncumulative. After the payment or the setting apart in any one fiscal year of five per cent. dividends upon the Five Per Cent. Convertible Preferred Stock B and upon the Common Stock of this corporation, the Five Per Cent. Profit Sharing Preferred Stock A shall be entitled to receive additional dividends at the same rate per cent. as any further or additional dividends which may be declared in that year upon such Common Stock. The Five Per Cent. Profit Sharing Preferred Stock A shall, at the option of this corporation, be redeemable as an entirety at any time after December 1, 1920, upon twelve weeks' notice, at the price of one hundred and ten per cent. (110%) of its par value. In the event of any liquidation, dissolution or winding up (whether voluntary or involuntary) of this corporation, the holders of the Five Per Cent. Profit Sharing Preferred Stock A shall be entitled to be paid in full, out of the assets of this corporation, the par amount of their stock and all dividends thereon declared and unpaid, before any amount shall be paid out of said assets to the holders of any other stock of this corporation; but after payment in full to the holders of the Five Per Cent. Convertible Preferred Stock B and Common Stock of this corporation of the par amount of their stock and all dividends thereon declared and unpaid, holders of all classes of stock of this corporation, without priority or distinction as between the different classes thereof, shall be entitled to participate pro rata in the remaining assets of this corporation.

[fol. 15] The Five Per Cent. Convertible Preferred Stock B shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. after payment of the full five per cent. dividends on the Five Per Cent. Profit Sharing Preferred Stock A, but before any divi-

dend shall be paid upon the Common Stock of this corporation. Said dividends shall be non-cumulative, and the Five Per Cent. Convertible Preferred Stock B shall not be entitled to any other or further dividends in any fiscal year. The holders of the Five Per Cent. Convertible Preferred Stock B may, at any time after August 1, 1918, and up to thirty days prior to any date fixed for the redemption of the entire issue of Five Per Cent. Profit Sharing Preferred Stock A, convert the same into, and exchange the same for, Five Per Cent. Profit Sharing Preferred Stock A and Common Stock of this corporation. For the purpose of such conversion this corporation shall have power, from time to time, to issue such amounts of its Five Per Cent. Profit Sharing Preferred Stock A and Common Stock in addition to the amounts hereby specifically authorized as may be necessary. Such conversion shall be at the rate of Fifty Dollars ($50) par value of Five Per Cent. Profit Sharing Preferred Stock A and Fifty Dollars ($50) par value of Common Stock for each One Hundred Dollars ($100) par value of Five Per Cent. Convertible Preferred Stock B, with a proper adjustment of declared and unpaid dividends. The Five Per Cent. Convertible Preferred Stock B shall, at the option of this corporation, be redeemable at an entirety at any time after December 1, 1920, upon twelve weeks' notice, at the price of one hundred and ten (110%) [fol. 16] per cent. of its par value. In the event of any liquidation, dissolution or winding up (whether voluntary or involuntary) of this corporation, the holders of the Five Per Cent. Convertible Preferred Stock B, shall be entitled to be paid in full, out of the assets of this corporation, the par amount of their stock and all dividends thereon declared and unpaid, before any amount shall be paid out of said assets to the holders of the Common Stock; but after payment in full to the holders of the Common Stock of the par amount of their Common Stock and all dividends thereon declared and unpaid, holders of all classes of stock of this corporation, without priority or distinction as between the different classes thereof shall be entitled to participate pro rata in the remaining assets of this corporation.

Fifth. This corporation is organized for the purpose of acquiring, owning, maintaining and operating the railroads,

property and franchises heretofore owned by The Wabash Railroad Company, which said railroad and property is situated partly within the State of Indiana and was purchased by Henry Rogers Winthrop and Robert Goelet, two of the undersigned, as a purchasing committee, at a sale thereof at one time and place, as an entirety, held on July 21, 1915, pursuant to a decree of foreclosure and sale entered on or about January 30, 1914, in certain judicial proceedings brought for the foreclosure of a mortgage of The Wabash Railroad Company, dated July 1, 1906, and known as its First Refunding and Extensions Mortgage, said decree of foreclosure and sale having been made and entered by the District Court of the United States for the Eastern [fol. 17] Division of the Eastern District of Missouri in a certain cause therein pending, wherein The Equitable Trust Company of New York, Trustee, was complainant and said The Wabash Railroad Company and another were defendants, which said decree was subsequently adopted and entered in certain ancillary causes between the same parties by the District Courts of the United States for the Western Division of the Western District of Missouri, Central Division of the Southern District of Iowa, District of Nebraska, District of Indiana, Eastern District of Illinois, Northern District of Illinois, Eastern Division, Southern District of Illinois, Southern Division, Southern District of New York, Eastern District of Michigan, Southern Division, Northern District of Ohio, Western Division, and which said sale was subsequently confirmed and made absolute by orders entered in all of said Courts.

Said railroads are described as follows: All and singular the lines of railroad formerly belonging to The Wabash Railroad Company and extending:

(1) From the City of Toledo, in a westerly direction into or through the Counties of Lucas, Fulton, Henry, Defiance and Paulding, in the State of Ohio, and the Counties of Allen, Huntington, Wabash, Miami, Cass, Carroll, Tippecanoe, Fountain and Warren, in the State of Indiana, [fol. 18] and the Counties of Vermilion, Champaign, Piatt, Macon, Sangamon, Morgan and Scott, in the State of Illinois, to Bluffs, in said State, and from Bluffs through Naples, in said County of Scott, to East Hannibal on the east bank of the Mississippi River in the County of Pike,

State of Illinois, including all property of the Railroad Company situate in the City of Hannibal, County of Marion and State of Missouri; from Bluffs into or through the Counties of Scott, Morgan, Pike, Brown and Adams in the State of Illinois, to Camp Point in said County of Adams; from Clayton into or through the Counties of Adams and Hancock, in the State of Illinois, to Elvaston, and from Hamilton, to a point on the east bank of the Mississippi River opposite Keokuk, Iowa, also a right-of-way between Elvaston and Hamilton; from Decatur into or through the Counties of Macon, Christian, Montgomery, Macoupin, Madison and St. Clair, in the State of Illinois, to East St. Louis in said State; from Effingham into or through the Counties of Effingham, Shelby, Moultrie, Piatt, McLean, Champaign and Ford, to Forrest in Livingston County, in the State of Illinois, and through the Counties of Livingston and LaSalle from Fairbury to Streator in said State; from Altamont, in the County of Effingham, State of Illinois, to Shumway in said County; from Forrest through the Counties of Livingston, Kankakee, Will and Cook, in the State of Illinois, to or near the City of Chicago, in said State; from Edwardsville, Madison County, Illinois, to Edwardsville Crossing in said County; from Detroit, in the State of Michigan, in a westerly direction, into or through the Counties of Wayne, Washtenaw, Monroe and Lenawee, in the State of Michigan, and from thence into or through [fol. 19] the Counties of Fulton and Williams, in the State of Ohio, and into or through the County of Dekalb to Butler, in the State of Indiana; from the City of St. Louis, State of Missouri, by the way of North Market Street and Bellefontaine to Ferguson in the County of St. Louis; from the Union Depot in the said City of St. Louis by the way of Forest Park to Ferguson and from thence in a northwesterly direction into and through the Counties of St. Louis, St. Charles, Warren, Montgomery, Audrain, Boone and Randolph, in the State of Missouri, to Moberly, in said State (including the bridge over the Missouri River at St. Charles), and from thence in a westerly direction into or through the Counties of Randolph, Chariton, Carroll, Ray, Clay and Jackson, in the State of Missouri, to Kansas City, in said State; from Salisbury in the County of Chariton, State of Missouri, to Glasgow in Howard County; from Mo-

berly in a northerly direction through the Counties of Randolph, Macon, Adair and Schuyler, in the State of Missouri, and from thence into or through the Counties of Appanoose, Davis and Wapello in the State of Iowa, to Ottumwa, in said State, and from Centralia, in the County of Boone, State of Missouri, to Columbia in said County and State.

(2) From Montpelier in the County of Williams, State of Ohio, in a southeasterly direction, into or through the Counties of Williams, Fulton and Lucas, in said State of Ohio, to a point of connection with the railroad of the Railroad Company at or near Maumee in said County of Lucas; from New Haven in the County of Allen, State of Indiana, into or through said County and the County of Dekalb, in said State, to a point of connection with the [fol. 20] railroad of the Railroad Company at or near Butler in the said County of Dekalb; from a point of connection with the railroad of the Railroad Company in the town of Montpelier in the County of Williams, State of Ohio, and extending in a westerly direction through said County and into or through the Counties of Steuben, La Grange, Noble, Elkhart, St. Joseph, Laporte, Porter and Lake, in the State of Indiana, to a point of connection with the tracks of the Baltimore and Ohio Chicago Terminal Railroad Company at or near Clarke Junction, in the State of Indiana.

(3) From the grounds of the Union Pacific Transfer in the City of Council Bluffs, Iowa, and from the freight depot of the Railroad Company, in the City of Council Bluffs, to a connection with the line from the Union Pacific Transfer, through the Counties of Pottawattamie, Mills, Fremont and Page, in said State of Iowa, and the Counties of Atchison, Nodaway, Gentry and Daviess, in the State of Missouri, to or near Pattonsburg, in said County of Daviess and State of Missouri.

(4) From a point of connection in or near the City of Des Moines with the tracks of the Des Moines Union Railway Company and extending from thence in a southeasterly direction through the Counties of Polk, Marion and Monroe to the town of Albia in said County of Monroe, from Albia in said County of Monroe, thence in a southerly direction

through the Counties of Monroe and Appanoose to a point in or near the town of Moulton in said County of Appanoose.

Also the right, title and interest formerly belonging to The Wabash Railroad Company in and to all or any of the [fol. 21] railroads, property, franchises, rolling stock, equipment and appurtenances of the following named companies, all of whose railroads, property and equipment was leased to The Wabash Railroad Company, namely:

The Brunswick and Chillicothe Railroad Company, a corporation organized under the laws of Missouri, owning a line of railroad extending from a point on the line of railroad of The Wabash Railroad Company at Brunswick, in the State of Missouri, in said State, to Chillicothe.

The St. Louis, Council Bluffs and Omaha Railway Company, a corporation organized under the laws of Missouri, owning a line of railroad extending from the City of Chillicothe, County of Livingston, State of Missouri, to a point at or near the town of Pattonsburg, in the County of Daviess, State of Missouri.

Also all the right, title and interest formerly belonging to The Wabash Railroad Company and to a line of railroad formerly belonging to the Champaign and Southeastern Railroad Company, extending from Champaign to Sidney in the County of Champaign, State of Illinois, and a line of railroad formerly belonging to the Attica, Covington and Southern Railway Company, extending from Attica to Covington in the County of Fountain, State of Indiana.

Sixth. This corporation shall have the power to sue and be sued, contract and be contracted with, and maintain and [fol. 22] operate the railroad in this certificate named, and to transact all business connected with the same, and shall also possess all the powers, rights, privileges, immunities and franchises in respect to said railroad purchased as aforesaid, and of all the real and personal property appertaining to the same, which were possessed or enjoyed by said The Wabash Railroad Company previous to said sale by virtue of its charter and amendments thereof and of the laws of the State of Indiana, or of any State in which any part of said railroad is situated and not inconsistent with the laws of the State of Indiana.

Seventh. This corporation shall have the power to assume any debts and liabilities of said The Wabash Railroad

Company and to make such adjustment and settlement with any stockholder or stockholders, or creditor or creditors, of said company as may be deemed expedient, and, for such purpose to use such portions of the bonds and stock of this corporation as may be deemed advisable, and in such manner as this corporation may deem proper.

This corporation shall have capacity to hold, enjoy and exercise within other States the aforesaid faculties, powers, rights, franchises and immunities, and such others as may be conferred upon it by any law of the State of Indiana or of any other State in which any portion of its railroad may be situated or in which it may transact any part of its business, and may hold meetings of its stockholders and of its board of directors and do all corporate acts and things without the State of Indiana as validly, and to the same extent, as it may do the same within said State, on the line of its road and may make by-laws, rules and regulations in relation to its business and the number of its directors and the times and places of holding meetings of [fol. 23] stockholders and directors, and may alter and change the same as may be deemed expedient.

This corporation shall also have, exercise and enjoy all and singular the other powers, privileges, franchises and immunities granted and allowed by the above-mentioned act of March 3, 1865, of the General Assembly of the State of Indiana, and of all acts supplemental thereof and amendatory thereto.

Witness our hands at the City of Indianapolis in the State of Indiana this 22nd day of October, A. D. 1915.

H. Brua Campbell, Robert Goelet, Lyman Rhoades, William Stuart, Henry Rogers Winthrop.

STATE OF INDIANA,
County of Maron, ss:

Before me, the undersigned, a notary public in and for the aforesaid state and county, duly qualified, personally came H. Brua Campbell, Robert Goelet, Lyman Rhoades, William V. Stuart and Henry Rogers Winthrop, known to me to be all of the persons described in and whose names are subscribed to the foregoing instrument, and duly and severally acknowledged the execution of the same this 22nd day of October, A. D. 1915.

Given under my hand and seal of office this 22nd day of October, A. D. 1915.

My commission expires October 29, 1918.

Theodore L. Locke, Notary Public. (Notarial Seal.)

[fol. 24] UNITED STATES OF AMERICA,
State of Indiana:

Office of the Secretary of State

I, Homer L. Cook, Secretary of State of the State of Indiana, hereby certify that the annexed pages contain a full, true and complete copy of the articles of association, or agreement in writing, of Wabash Railway Company with the several certificates thereon, filed October 22nd, 1915, as the same appears on file, as the law directs, in this office.

In Testimony Whereof, I hereunto set my hand and affix the Great Seal of the State of Indiana. Done at my office in the City of Indianapolis, this 22nd day of October, A. D. 1915.

Homer L. Cook, Secretary of State. (Seal of the State of Indiana.)

[fol. 25] EXHIBIT B TO BILL OF COMPLAINT

No. —. Shares $100 Each. Shares —

Incorporated Under the Laws of the State of Indiana

Wabash Railway Company

Five per Cent. Profit-sharing Preferred Stock A

This certifies that —— —— is the owner of — fully paid and non-assessable shares of the Five Per Cent. Profit Sharing Preferred Stock A of Wabash Railway Company of the par value of One Hundred Dollars ($100) each, transferable in person or by attorney on surrender of this certificate duly endorsed. The holders of the Five Per Cent. Profit Sharing Preferred Stock A of the Company shall be entitled to receive preferential dividends in each

fiscal year up to the amount of five per cent. before any dividends shall be paid upon any other stock of the Company, but such preferential dividends shall be non-cumulative. The holders of the Five Per Cent. Convertible Preferred Stock B of the Company shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. after payment of the full five per cent. dividend on the Five Per Cent. Profit Sharing Preferred Stock A, but before any dividends shall be paid upon the Common Stock, but such preferential dividends shall be non-cumulative, and the holders of the Five Per Cent. Convertible Preferred Stock B shall not be entitled to any [fol. 26] other or further dividends in any fiscal year. After the payment or the setting apart in any one fiscal year of five per cent. dividends upon the Five Per Cent. Convertible Preferred Stock B, and upon the Common Stock, the holders of the Five Per Cent. Profit Sharing Preferred Stock A shall be entitled to receive additional dividends at the same rate per cent. as any further or additional dividends which may be declared in that year upon the Common Stock. The Five Per Cent. Profit Sharing Preferred Stock A shall, at the option of the Company, be redeemable as an entirety at any time after December 1, 1920, upon twelve weeks' notice at the price of One Hundred and Ten per cent. of its par value, and the Five Per Cent Convertible Preferred Stock B, at the option of the Company, shall be redeemable as an entirety at any time after December 1, 1920, upon like notice and at the same price. The holders of the Five Per Cent Convertible Preferred Stock B may at any time after August 1, 1918, and up to thirty days prior to any date fixed for the redemption of the entire issue of Five Per Cent Profit Sharing Preferred Stock A, convert the same into and exchange the same for Five Per Cent Profit Sharing Preferred Stock A and Common Stock at the rate of Fifty Dollars ($50) par value of Five Per Cent Profit Sharing Preferred Stock A, and Fifty Dollars ($50) par value of Common Stock for each One Hundred Dollars ($100) par value of Five Per Cent Convertible Preferred Stock B, with a proper adjustment of declared and unpaid dividends. In the event of any liquidation, dissolution or winding up (whether vol-

untary or involuntary) of the Company, (1) the holders of the Five Per Cent Profit Sharing Preferred Stock A [fol. 27] shall be entitled to be paid in full out of the assets of the Company the par amount of their stock and all dividends thereon declared and unpaid before any amount shall be paid out of said assets to the holders of any other stock of the Company, (2) the holders of the Five Per Cent Convertible Preferred Stock B shall then be entitled to be paid in full out of the assets of the Company the par amount of their stock and all dividends thereon declared and unpaid before any amount shall be paid out of said assets to the holders of the Common Stock, (3) the holders of the Common Stock shall then be entitled to be paid in full out of the assets of the Company the par amount of their stock and all dividends thereon declared and unpaid, and (4) thereafter the holders of all classes of stock of the Company, without priority or distinction as between the different classes thereof, shall be entitled to participate pro rata in the remaining assets of the Company. Holders of all shares of stock of the Company have equal voting rights share for share alike. Reference is hereby made to the Certificate of Incorporation of the Company, to all the provisions of which this certificate and the rights of the holder of stock represented hereby are subject, for a statement of the rights and privileges of and the limitations upon the various classes of the Company's stock and of the obligations of the Company with respect thereto and for its provisions generally as if herein set forth in full. The holder hereof by the acceptance of this certificate assents to all of the provisions of said Certificate of Incorporation and consents to and authorizes such action as may be necessary to carry the same into effect.

[fol. 28] In witness whereof the Company has caused this certificate to be signed by its proper officers and its corporate seal to be hereto affixed ——— —, ———.

——— ———, Vice-President. ——— ———, Secretary.

[fol. 29] IN UNITED STATES DISTRICT COURT

[Title omitted]

ANSWER OF WABASH RAILWAY COMPANY

Wabash Railway Company, defendant herein (hereinafter called the Railway Company), for its answer to the Bill of Complaint of the plaintiff above named, respectfully shows and alleges as follows:

First. The Railway Company admits that it is a corporation duly organized and existing under the laws of the State of Indiana and is a citizen and resident of that State, and upon information and belief it admits the citizenship of the plaintiff John C. Barclay and of the individual defendants and admits that Myron S. Hall & Company and C. D. Halsey & Company have offices in the City of New York, as alleged in paragraph First of the Bill of Complaint.

[fol. 30] Second. The Railway Company admits the allegations contained in paragraph Second of the Bill of Complaint.

Third. The Railway Company admits the allegations contained in paragraph Third of the Bill of Complaint.

Fourth. The Railway Company admits the allegations contained in paragraph Fourth of the Complaint, but for greater certainty begs leave to refer to the Certificate of Incorporation, a true copy of which is annexed to the Bill of Complaint as "Exhibit A" thereto.

Fifth. The Railway Company admits that the plaintiff is and for several years last past has been the owner and holder of 100 shares of the par value of $100 each of the Five Per Cent Profit Sharing Preferred Stock A of the Railway Company (herein and in the Bill of Complaint sometimes referred to as Preferred Stock "A") and admits that Myron S. Hall & Company, C. D. Halsey & Company and Earl Krapp are respectively the registered owners or holders of the amounts of stock mentioned in paragraph Fifth of the Bill of Complaint.

Sixth. The Railway Company admits that the owners and holders of the Five Per Cent Convertible Preferred

Stock B (herein and in the Bill of Complaint sometimes referred to as Preferred Stock "B") and Common Stock of the Railway Company are numerous and widely scattered, but denies that many of them are unknown to the plaintiff and avers that the plaintiff, through his attorneys, [fol. 31] has been given access to and is familiar with the stock books of the Railway Company. The Railway Company admits that defendants other than the Railway Company have been made parties as representatives of the holders of Preferred Stock "B" and Common Stock of the Railway Company.

Seventh. The Railway Company admits the allegations contained in paragraph Seventh of the Bill of Complaint, but for greater certainty begs leave to refer to its Certificate of Incorporation and the Certificate for its Preferred Stock "A," true copies of which are annexed to the Bill of Complaint, marked respectively "Exhibit A" and "Exhibit B."

Eighth. The Railway Company admits the allegations contained in paragraph Eighth of the Complaint respecting the payment and non-payment of dividends between the years 1915 and 1926, but it denies that there were large net earnings available for dividends on its Preferred Stock "A" in the period mentioned in said paragraph and denies that its earnings in any part or parts of said period justified the payment of any dividends which were not actually paid, and, although admitting balances of net earnings in certain non-dividend periods over expenses and prior charges, the Railway Company denies that any part of such balances could, consistently with its lawful obligations to its stockholders, or with its duties to the public in safe and efficient maintenance of property and service, or with sound discretion and the duty of its directors, have been distributed to stockholders, and avers that its entire surplus earnings of all periods since the incorpora- [fol. 32] tion of the Railway Company not actually distributed to stockholders and not reserved for working capital or necessary corporate requirements has been actually appropriated to and is now represented by fixed and permanent improvements and additions to the property and equipment of the Railway Company to enable it adequately

to discharge its public duties and protect its property, and that no part of such alleged surplus is represented by any cash or liquid fund or by any accumulation of cash assets available for dividends.

Ninth. The Railway Company admits the allegations contained in paragraph Ninth of the Bill of Complaint, except that while admitting that balances of net earnings over expenses and prior charges in the period referred to in said paragraph were carried to its surplus account and used for additional working capital and other purposes, it denies the availability of such surplus for dividends on the Preferred Stock "A."

Tenth. Answering paragraph Tenth of the Complaint, the Railway Company while admitting balances of net earnings over expenses and prior charges in substantial amounts during the period from its organization to May 25, 1918, it denies the availability of net earnings for dividends upon the Preferred Stock "A" beyond the amounts actually distributed by the Railway Company, and it denies the materiality of the hypothesis presented in paragraph Tenth of the Complaint and the accuracy of the plaintiff's computations based thereon.

Eleventh. The Railway Company admits the allegations contained in paragraph Eleventh of the Bill of Complaint.

[fol. 33] Twelfth. Answering paragraph Twelfth of the Bill of Complaint, the Railway Company denies any purpose to inaugurate regular dividends upon the Preferred Stock "B" and upon the Common Stock of the Railway Company and alleges that the question of dividends upon either of said classes of stock will necessarily be determined by the Board of Directors in the exercise of its proper and lawful discretion from time to time in the light of conditions existing when such discretion is exercised and which, in the nature of things, it is impracticable to forecast or foresee; but the Railway Company denies that the right of the Board to declare and pay dividends upon its Preferred Stock "B" or upon its Common Stock is contingent upon or in any manner related to the payment of dividends upon the Preferred Stock "A" in prior years, and avers in this behalf that it is free in any fiscal year in

which dividends amounting to 5% have been paid upon the Preferred Stock "A" to pay dividends up to 5% upon the Preferred Stock "B" and is free in any fiscal year in which dividends upon the Preferred Stock "B" amounting to 5% have been paid or set apart to declare dividends upon the Common Stock. Accordingly, all averments of threatened wrongful diversion of surplus earnings from the payment of dividends upon the Preferred Stock "A" of the Railway Company are denied.

Thirteenth. Answering paragraph Thirteenth of the Bill of Complaint the Railway Company denies any prejudgment as to its future dividend action but it admits that it will pursue its unqualified right to act upon the declaration and payment of dividends on its Preferred Stock "B" and Common Stock without regard to the qualifications and [fol. 34] limitations inferentially alleged in said paragraph Thirteenth and except as thus admitted, it denies the allegations of paragraph Thirteenth of the Bill of Complaint.

Fourteenth. Answering paragraph Fourteenth of the Bill of Complaint, the Railway Company begs leave to refer to its Certificate of Incorporation and the Certificate for its Preferred Stock "A", true copies of which are annexed to the Bill of Complaint, marked respectively "Exhibit A" and "Exhibit B".

Fifteenth. The Railway Company denies the allegations contained in paragraph Fifteenth of the Bill of Complaint and avers in this behalf that each fiscal year is a separate accounting and dividend period and that it may declare in each such year the dividends specified in its Certificate of Incorporation and in the Certificates representing its Preferred Stock "A", Preferred Stock "B" and Common Stock without regard to the payment or non-payment of dividends upon any of its three issues of stock in previous accounting periods and without regard to the existence or non-existence of earnings in such periods.

Wherefore the Railway Company prays for a dismissal of the Bill of Complaint with its costs most unjustly sustained.

Pierce & Greer, Solicitors for the Defendant Wabash Railway Company, 37 Wall Street, New York City, New York. Charles E. Hughes, Winslow S. Pierce, F. C. Nicodemus, Jr., Counsel.

[fol. 35] *Duly sworn to by John C. Otteson. Jurat omitted in printing.*

[fol. 36] In United States District Court

[Title omitted]

Answer of Gerald V. Hollins, Shirley P. Austin, George R. Leslie, and Earl Krapp

The defendants above-named, Gerald V. Hollins, Shirley P. Austin, George R. Leslie and Earl Krapp, by Hughes, Rounds, Schurman & Dwight, their solicitors, respectfully answer the Bill of Complaint herein, on information and belief, as follows:

First. They admit that Wabash Railway Company is a corporation duly organized and existing under the laws of the State of Indiana and is a citizen and resident of that state, and they admit the citizenship of the plaintiff John C. Barclay and of the individual defendants and admit that Myron S. Hall & Company and C. D. Halsey & Company have offices in the City of New York, as alleged in Paragraph First of the Bill of Complaint.

[fol. 37] Second. They admit the allegations contained in Paragraph Second of the Bill of Complaint.

Third. They admit the allegations contained in Paragraph Third of the Bill of Complaint.

Fourth. They admit the allegations contained in Paragraph Fourth of the Complaint, but for greater certainty beg leave to refer to the Certificate of Incorporation, a true copy of which is annexed to the Bill of Complaint as "Exhibit A" thereto.

Fifth. They admit that the plaintiff is and for several years last past has been the owner and holder of 100 shares of the par value of $100 each of the Five Per Cent. Profit Sharing Preferred Stock A of the Railway Company (herein and in the Bill of Complaint sometimes referred to as Preferred Stock "A") and admit that Myron S. Hall & Company, C. D. Halsey & Company and Earl Krapp are respectively the registered owners or holders of the amounts of stock mentioned in Paragraph Fifth of the Bill of Complaint.

Sixth. They admit that the owners and holders of the Five Per Cent. Convertible Preferred Stock B (herein and in the Bill of Complaint sometimes referred to as Preferred Stock "B") and Common Stock of the Railway Company are numerous and widely scattered, but deny that many of them are unknown to the plaintiff and aver that the plaintiff, through his attorneys, has been given access to and is familiar with the stock books of the Railway Company. They admit that defendants other than the Railway Company have been made parties as representatives of the [fol. 38] holders of Preferred Stock "B" and Common Stock of the Railway Company.

Seventh. They admit the allegations contained in Paragraph Seventh of the Bill of Complaint, but for greater certainty beg leave to refer to said Certificate of Incorporation and the Certificate for Preferred Stock "A", true copies of which are annexed to the Bill of Complaint, marked respectively "Exhibit A" and "Exhibit B".

Eighth. They admit the allegations contained in Paragraph Eighth of the Complaint respecting the payment and non-payment of dividends between the years 1915 and 1926, but they deny that there were large net earnings available for dividends on the Railway Company's Preferred Stock "A" in the period mentioned in said paragraph and deny that its earnings in any part or parts of said period justified the payment of any dividends which were not actually paid, and, although admitting balances of net earnings in certain non-dividend periods over expenses and prior charges, they deny that any part of such balances could, consistently with the Railway Company's lawful obligations to its stockholders, or with its duties to the public

in safe and efficient maintenance of property and service, or with sound discretion and the duty of its directors, have been distributed to stockholders, and aver that the Railway Company's entire surplus earnings of all periods since its incorporation not actually distributed to stockholders and not reserved for working capital or necessary corporate requirements has been actually appropriated to [fol. 39] and is now represented by fixed and permanent improvements and additions to the property and equipment of the Railway Company to enable it adequately to discharge its public duties and protect its property, and that no part of such alleged surplus is represented by any cash or liquid fund or by any accumulation of cash assets available for dividends.

Ninth. They admit the allegations contained in Paragraph Ninth of the Bill of Complaint, except that while admitting that balances of net earnings over expenses and prior charges in the period referred to in said paragraph were carried to its surplus account and used for additional working capital and other purposes, they deny the availability of such surplus for dividends on the Preferred Stock "A."

Tenth. Answering Paragraph Tenth of the Complaint, while admitting balances of net earnings over expenses and prior charges in substantial amounts during the period from its organization to May 25, 1918, they deny the availability of net earnings for dividends upon the Preferred Stock "A" beyond the amounts actually distributed by the Railway Company, and they deny the materiality of the hypothesis presented in Paragraph Tenth of the Complaint and the accuracy of the plaintiffs computations based thereon.

Eleventh. They admit the allegations contained in Paragraph Eleventh of the Bill of Complaint.

[fol. 40] Twelfth. Answering Paragraph Twelfth of the Bill of Complaint, they deny that the Railway Company has any purpose to inaugurate regular dividends upon the Preferred Stock "B" and upon the Common Stock of the Railway Company and allege that the question of dividends upon either of said classes of stock will necessarily be determined by the Board of of Directors of the Railway

Company in the exercise of its proper and lawful discretion from time to time in the light of conditions existing when such discretion is exercised and which, in the nature of things, it is impracticable to forecast or forsee; but they deny that the right of the Board to declare and pay dividends upon the Preferred Stock "B" or upon the common Stock is contingent upon or in any manner related to the payment of dividends upon the Preferred Stock "A" in prior years, and aver in this behalf that it is free in any fiscal year in which dividends amounting to 5% have been paid upon the Preferred Stock "A" to pay dividends up to 5% upon the Preferred Stock "B" and is free in any fiscal year in which dividends upon the Preferred Stock "B" amounting to 5% have been paid or set apart to declare dividends upon the Common Stock. Accordingly, all averments of threatened wrongful diversion of surplus earnings from the payment of dividends upon the Preferred Stock "A" of the Railway Company are denied.

Thirteenth. Answering Paragraph Thirteenth of the Bill of Complaint, they deny any prejudgment by the Railway Company as to its future dividend action, but they admit that it will pursue its unqualified right to act upon the [fol. 41] declaration and payment of dividends on its Preferred Stock "B" and Common Stock without regard to the qualifications and limitations inferentially alleged in said Paragraph Thirteenth and except as thus admitted, they deny the allegations of Paragraph thirteenth of the Bill of Complaint.

Fourteenth. Answering Paragraph Fourteenth of the Bill of Complaint, they beg leave to refer to the Certificate of Incorporation and the Certificate for Preferred Stock "A" of the Railway Company, true copies of which are annexed to the Bill of Complaint, marked respectively "Exhibit A" and "Exhibit B."

Fifteenth. They deny the allegations contained in Paragraph Fifteenth of the Bill of Complaint and aver in this Behalf that each fiscal year is a separate accounting and dividend period and that the Railway Company may declare in each such year the dividends specified in its Certificate of Incorporation and in the Certificates representing its Preferred Stock "A," Preferred Stock "B" and Common

Stock without regard to the payment or non-payment of dividends upon any of its three issues of stock in previous accounting periods and without regard to the existence or non-existence of earnings in such periods.

Wherefore said defendants pray for a dismissal of the Bill of Complaint with their costs most unjustly sustained.

Hughes, Rounds, Schurman & Dwight, Solicitors for the Defendants, Gerald V. Hollins, Shirley P. Austin, George R. Leslie, and Earl Krapp, 100 Broadway, New York City, New York. Charles E. Hughes, Counsel.

[fol. 42] *Duly sworn to by Gerald V. Hollins. Jurat omitted in printing.*

[fol. 43] IN UNITED STATES DISTRICT COURT

[Title omitted]

ANSWER OF MYRON S. HALL, H. W. COHU, AND LA MOTTE COHU

Myron S. Hall, H. W. Cohu and La Motte Cohu, defendants herein, for their answer to the Bill of Complaint of the plaintiff above named, respectfully allege as follows:

First. They admit they are copartners doing business under the firm name and style of Myron S. Hall & Company, having their principal office at 100 Broadway, New York City, New York, and upon information and belief they admit the other allegations of paragraph First of the complaint.

Second. They admit the allegations of the plaintiff as alleged in paragraph Second of the complaint.

[fol. 44] Third. They admit the allegations of the plaintiff as alleged in paragraph Third of the complaint.

Fourth. They admit the allegations contained in paragraph Fourth of the complaint, but for greater certainty beg leave to refer to the certificate of incorporation, a true copy of which is annexed to the Bill of Complaint as Exhibit "A" thereto.

Fifth. They admit that they are the registered holders of 2,197 shares of preferred stock "B" of the Railway Company, and upon information and belief admit the other allegations as alleged in paragraph Fifth of the complaint.

Sixth. They admit the allegations contained in paragraph Sixth of the complaint, except the allegation that many of the owners and holders of the preferred stock "B" and of the common stock of the Railway Company are unknown to the plaintiff, as to which allegation they deny they have knowledge or information sufficient to form a belief as to the truth thereof.

Seventh. They admit the allegations contained in paragraph Seventh of the complaint, but for greater certainty beg leave to refer to the certificate of incorporation and the certificate for the preferred stock "A," true copies of which are annexed to the complaint marked respectively Exhibit "A" and Exhibit "B."

Eighth. They admit upon information and belief, the allegation contained in paragraph Eighth of the complaint [fol. 45] respecting the payment and non-payment of dividends between the years 1915 and 1926; they also admit, upon information and belief, the allegations contained in said paragraph Eighth of the complaint with respect to the net earnings of the Railway Company and, upon information and belief, they aver that said net earnings in some of the fiscal years of said period were sufficient to pay, either in whole or in part, the preferential dividend of five per cent on the said preferred stock "B" of the Railway Company; they deny that they have knowledge or information sufficient to form a belief as to the truth of the allegations contained in said paragraph Eighth of the complaint with respect to the availability of said net earnings for the payment of dividends upon the preferred stock "A" of the Railway Company.

Ninth. They admit, upon information and belief, the allegation contained in paragraph Ninth of the complaint with respect to the disposition by the Railway Company of its earnings, but deny that they have knowledge or information sufficient to form a belief as to the truth of the allegation contained in said paragraph Ninth with respect to the

availability of said earnings for dividends on preferred stock "A" of the Railway Company.

Tenth. They deny that they have knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph Tenth of the complaint.

Eleventh. They admit the allegations contained in paragraph Eleventh of the complaint.

[fol. 46] Twelfth. They admit, upon information and belief, that the Railway Company since May 1, 1925, has, in each fiscal year, had net earnings more than sufficient to pay in full the preferential five per cent dividend on its said preferred stock "A," and they aver that the same is likewise true with reference to the preferential dividend on its preferred stock "B"; they deny that they have knowledge or information sufficient to form a belief as to the truth of the allegations contained in said paragraph Twelfth of the complaint respecting the availability of earnings for the payment of dividends for fiscal years prior to 1926, as to the financial condition of the Railway Company or its intention with respect to the payment of regular dividends upon its preferred stock "B" and common stock; they deny the allegations contained in said paragraph Twelfth to the effect that the right of the Railway Company to declare and pay dividends upon its preferred stock "B" is contingent upon, or in any manner related to, the payment of dividends upon the preferred stock "A" in prior years, or that any such declaration and payment of dividends on the preferred stock "B" would be depriving the holders of preferred stock "A," including the plaintiff, of dividend rights inhering in said preferred stock "A", or diverting from said preferred stock "A" earnings available for dividends thereupon.

Thirteenth. They admit, upon information and belief, the allegations contained in paragraph Thirteenth of the complaint, except that they deny that they have knowledge or information sufficient to form a belief as to the truth of the allegation with respect to the availability of net earn-
[fol. 47] ings for dividends on preferred stock "A" for prior fiscal years.

Fourteenth. Answering paragraph Fourteenth of the complaint, they beg leave to refer to the certificate of incorporation and certificate for the preferred stock "A" true copies of which are annexed to the Bill of Complaint marked respectively Exhibit "A" and Exhibit "B."

Fifteenth. They deny the allegations contained in paragraph Fifteenth of the complaint, and aver in this respect that each fiscal year is a separate accounting and dividend period and that the Railway Company may declare in and for each such year the dividends specified in its certificate of incorporation and in the certificates representing its preferred stock "A," and in the event of its declaring and paying in or for any such fiscal year five per cent upon its preferred stock "A," as specified in its certificate of incorporation, the preferred stock "B" shall thereupon be entitled to receive out of the net earnings of said fiscal year a preferential dividend up to the amount of five per cent before the holders of either preferred stock "A" or common stock are entitled to receive any dividend in and for a succeeding fiscal year and without regard to the payment of non-payment of dividends upon the preferred stock "A" in or for previous fiscal years.

For a separate and distinct defense and claim, these defendants further answer:

Sixteenth. They allege and aver that in the event it be decreed that the holders of preferred stock "A" are en- [fol. 48] titled to receive a dividend of five per cent in and for any specific fiscal year or accounting period during the period from 1915 to 1926 inclusive, that the holders of preferred stock "B" are likewise entitled to receive from net earnings a dividend in and for said specific fiscal year up to five per cent before the holders of either preferred stock "A" or common stock are entitled to receive any dividend in and for a succeeding fiscal year.

Seventeenth. They allege and aver that the Railway Company has declared and paid to holders of its preferred stock "A" a dividend of five per cent in and for the fiscal year 1927 and that there is now due and owing to the holders of preferred stock "B" from available net earnings for the current fiscal year a dividend of five per cent

for the fiscal year of 1927, which said dividend should be declared and paid by the Railway Company.

Wherefore these defendants pray for a dismissal of the complaint herein with respect to the prayer for relief as contained in Sections 3 and 4 of paragraph Sixteenth of the complaint with respect to the issuing of interlocutory and permanent injunctions, and these defendants further pray that in the event this Honorable Court decree that the holders of said preferred stock "A" of the Railway Company are entitled to receive preferential dividends of five per cent for any fiscal year from 1915 to 1926 inclusive, that in such event this Honorable Court decree that the holders of the said preferred stock "B" of the Railway Company are thereupon entitled to receive from the net earnings in [fol. 49] said fiscal year a preferential dividend up to five per cent for such fiscal year, and before the holders of said preferred stock "A" and of common stock are entitled to receive a dividend for any succeeding fiscal year. And these defendants further pray that this Honorable Court decree that the holders of said preferred stock "B" are entitled to receive a preferential dividend of five per cent for the fiscal year 1927 and that the Railway Company should forthwith declare and pay such dividend, and these defendants further pray that they have such other and further relief as may be meet and just in the premises.

Taylor & Roberts, Solicitors for Defendants Myron S. Hall, H. W. Cohu, and La Motte Cohu, 56 Pine Street, New York City, N. Y. Winthrop Taylor, of Counsel.

[fol. 50] *Duly sworn to by Myron S. Hall. Jurat omitted in printing.*

[fol. 51] In United States District Court

[Title omitted]

Order Joining William Fraser Dickson as Party Defendant

Upon reading and filing the consent hereto annexed, it is hereby

Ordered that William Fraser Dickson, a resident of La Anna, Pennsylvania, and owner and holder of more than 1,000 shares of the common capital stock of the defendant, Wabash Railway Company, be, and hereby it, added as a party defendant in the above-entitled cause with the same force and effect as though originally joined as such herein.

Jno. Knox, U. S. D. J.

Dated New York, December 1, 1927.

[fol. 52] In United States District Court

[Title omitted]

Answer of William Fraser Dickson

William Fraser Dickson, a defendant herein, for his answer to the Bill of Complaint of the plaintiff above named, respectfully shows and alleges as follows:

First. He admits, on information and belief, that John C. Barclay, the plaintiff, is a citizen and resident of the State of New Jersey, residing at Montclair in said State. That the defendant, Wabash Railway Company, is a corporation duly organized and existing under the laws of the State of Indiana and is a citizen and resident of said State and has an office at 120 Broadway, New York City; that Myron S. Hall & Co. and C. D. Halsey & Company have offices in the City of New York, as alleged in the First paragraph of the Bill of Complaint.

[fol. 53] Second. He admits the allegation contained in the Second paragraph of the Bill of Complaint.

Third. He admits the allegations contained in the Third paragraph of the Bill of Complaint.

Fourth. He admits the allegations contained in the Fourth paragraph of the Bill of Complaint, but for greater certainty begs leave to refer to the certificate of incorporation, a copy of which is annexed to the Bill of Complaint as Exhibit "A" thereto.

Fifth. He admits that the plaintiff is and since 1926 has been the owner and holder of one hundred (100) shares, each of the par value of $100, of the 5% profit-sharing, Preferred "A" stock of the defendant Railway Company (herein and in the Bill of Complaint sometimes referred to as Preferred Stock "A"), and admits that Myron S. Hall & Company, C. D. Halsey & Company and Earl Krapp are respectively the registered owners or holders of the amount of stock mentioned in paragraph Fifth of the Bill of Complaint.

Sixth. He admits that the owners and holders of the 5% convertible Preferred Stock "B" (herein and in the Bill of Complaint referred to as Preferred Stock "B") and Common Stock of the Railway Company are numerous and widely scattered, but, upon information and belief, denies that many of them are unknown to the plaintiff; and he admits that the defendants, other than the Railway Company, have been made parties as representatives of the holders of Preferred Stock "B" and Common Stock of the Railway Company.

[fol. 54] Seventh. He admits the allegation contained in paragrah Seventh of the Bill of Complaint, but for greater certainty begs leave to refer to its certificate of incorporation and the certificate for its Preferred Stock "A," true copies of which are annexed to the Bill of Complaint marked respectively "Exhibit A" and "Exhibit B."

Eighth. He admits the allegations contained in paragraph Eighth of the Bill of Complaint respecting payment and non-payment of dividends between the years 1915 and 1926, but denies that there were large net earnings available for dividends on its Preferred Stock "A" in the period mentioned in said paragraph, and denies that its earnings in any part or parts of said period justified the payment of any dividends which were not actually paid; and alleges that the application of balances of net earnings over expenses and prior charges by the Railway Company was in all respects proper and in pursuance of the wise and prudent exercise of their discretion by the Directors of said Railway Company. The defendant admits balances of net earnings in certain non-dividend periods over and above

expenses and prior charges, but denies that they were available for or could have been by the Directors properly applied to the payment of dividends upon the stock of the said Railway Company (except to the extent that they were actually so applied), or that consistent with its legal obligations to its stockholders and its duties to the public in connection with the exercise of a sound discretion by its Directors in the exercise of their duties, such balances, or any part thereof, could have been distributed to the stockholders, and alleges, upon information and belief, that the [fol. 55] surplus earnings of the Railway Company not actually distributed to stockholders and not reserved for working capital or necessary corporate requirements, has been properly appropriated to and is now represented by fixed and permanent improvements and additions to the property and equipment of the Railway Company to enable it adequately to discharge its duties as a common carrier and protect its property, and that no part of such alleged surplus is represented by cash or other assets available for dividends.

Ninth. He denies that the earnings of the Railway Company referred to in paragraph Ninth of the Bill of Complaint were available for dividends on the Preferred Stock "A" during the periods therein referred to, or that they are so available now; but admits that earnings during the periods therein referred to were retained by the Railway Company and carried to a surplus account and used for additional working capital and other purposes, which he alleges were in all respects proper and so applied by the Directors in a wise exercise of their discretion.

Tenth. Answering the paragraph Tenth of the Bill of Complaint, he admits that the Railway Company had balances of net earnings over expenses and prior charges in substantial amounts during the period from its organization to May 25th, 1925, but denies the availability of such net earnings for dividends upon Preferred Stock "A" beyond the amounts actually distributed by the Railway Company. He denies the accuracy of the plaintiff's computation set forth in the said paragraph of the Bill of Com- [fol. 56] plaint, but admits that surplus net earnings were during said period carried by the Railway Company to sur-

plus account and used for additional working capital and other proper corporate purposes.

Eleventh. He admits the allegations contained in paragraph Eleventh of the Bill of Complaint.

Twelfth. Answering paragraph Twelfth of the Bill of Complaint, he admits that the Railway Company since May 1st, 1925, has had in each year net earnings in amounts in excess of an amount equal to 5% upon its outstanding Preferred "A" Stock, but denies that such net earnings were available for the payment of dividends upon the Preferred "A" Stock except to the extent that they were during said period actually so applied. He admits that the Railway Company is now in strong financial position, but denies that it no longer needs to retain a substantial surplus or that its net earnings in prior fiscal years were available for dividends upon its Preferred "A" Stock which were unpaid in such years. He denies that the payment of dividends upon the Preferred "B" and Common Stock of the Railway Company would in any way deprive holders of the Preferred "A" Stock of any rights inherent therein and denies that it would divert from said Preferred "A" Stock net earnings available for dividends thereon which were not paid; and he alleges that the question of dividends to be paid upon its various classes of stock must necessarily be determined by the Board of Directors of said Railway Company in the exercise of a wise and proper discretion from time to time, and that the right of said directors to [fol. 57] declare and pay dividends upon its Preferred "B" and its Common Stock is not contingent upon or in any manner related to the payment of dividends upon the Preferred Stock "A" in prior years and that the said Board of Directors is free in any fiscal year in which dividends amounting to 5% upon the Preferred Stock "A" are declared, to pay dividends up to 5% upon the Preferred Stock "B," which having been paid or set apart and there remaining sufficient net earnings thereto available, to declare and pay dividends upon the Common Stock, and he denies all averments of threatened alleged wrongful diversion of surplus earnings from the payment of dividends upon the Preferred Stock "A" of the Railway Company.

Thirteenth. Answering paragraph Thirteenth of the Bill of Complaint, he alleges that the Railway Company had the right to pay the dividends upon the Preferred "B" Stock which have hitherto been paid or declared, and that it has the right to pay future dividends thereon and on the Common Stock in each fiscal year out of its net earnings in such fiscal year remaining after the payment of a 5% dividend on its said Preferred Stock "A" in said fiscal year and wholly without regard to the question as to whether or not dividends on such Preferred Stock "A" have been paid in prior fiscal years and whether or not in such prior fiscal years net earnings were available for the payment of dividends on such Preferred Stock "A."

Fourteenth. Answering paragraph Fourteenth of the Bill of Complaint, he denies that to the extent that in any [fol. 58] fiscal year the Railway Company has had net earnings equivalent to or in excess of an amount equal to 5% upon its outstanding Preferred "A" Stock but such dividend has not been paid thereon, the holders of said stock are entitled to receive such unpaid dividends before any dividends may be declared or paid by the Railway Company to the holders of stock of any other class in any subsequent year, and for a greater certainty in respect to the legal obligations of the Railway Company with respect to the dividend rights of its various classes of stockholders he begs leave to refer to the certificate of incorporation and the certificate of its Preferred Stock "A," copies of which are annexed to the Bill of Complaint marked respectively "Exhibit A" and "Exhibit B."

Fifteenth. He denies each and every of the allegations contained in paragraph Fifteenth of the Bill of Complaint and alleges that under the terms of its articles of incorporation each fiscal year is a separate accounting and dividend period of the Railway Company, and that it may declare in each such year the dividends specified therein and in its certificates representing its various classes of stock without regard to the payment or non-payment of dividends upon any of its three issues of stock in previous accounting periods and without regard to the existence or non-existence of earnings in such period.

Sixteenth. Answering paragraph Sixteenth of the Bill of Complaint, he alleges, upon information and belief, that the plaintiff has been in no manner injured by the matters com-
[fol. 59] plained of in the said Bill of Complaint, and is therefore not entitled to the relief prayed for or any part thereof.

Seventeenth. And he further alleges that he is a resident of La Anna, Pennsylvania, is and has for several years last past been the owner and holder of more than 1,000 shares of the common stock of the defendant Wabash Railway Company, and that he was added as a party defendant to this action by order of the above court on December 1st, 1927, and with the same force and effect as though originally joined as such a party herein.

Wherefore the defendant William Fraser Dickson prays for a dismissal of the Bill of Complaint with his costs most unjustly sustained.

Davis, Wagner, Heater & Holton, Solicitors for the Defendant William Fraser Dickson. Office and Postoffice address: 120 Broadway, Manhattan New York City. Arnold L. Davis, of Counsel.

[fol. 60] *Duly sworn to by William Fraser Dickson. Jurat omitted in printing.*

[fol. 61] In United States District Court

[Title omitted]

Notice of Motion for Interlocutory Injunction

Please take notice that upon the Bill of Complaint herein, verified the 15th day of November, 1927, the Answer of defendant Wabash Railway Company, verified the 28th day of November, 1927, the Answer of defendants Myron S. Hall, H. W. Cohu and La Motte Cohu, verified the 29th day of November, 1927, all filed herein, and upon the Affidavit of William R. Begg, sworn to the 6th day of December, 1927, the undersigned will move this Court at a term thereof for motions to be held at the Old Post Office Build-

ing, Broadway and Park Row, Borough of Manhattan, New York City, on the 13th day of December, 1927, at the opening of Court on that day or as soon thereafter as counsel can be heard for an interlocutory injunction enjoining and restraining the Railway Company, its agents, attorneys, servants and officers temporarily and pending the determination of this suit from declaring or paying any dividends upon the Preferred Stock B of said Railway Company or any dividends upon the Common Stock thereof [fol. 62] unless there shall first have been paid all the preferential dividends at the rate of five per cent in each fiscal year upon its Preferred Stock A from the date of the organization of the Railway Company down to and including the fiscal year 1926 to the extent that the Railway Company has had net earnings available for the payment of such dividends and to the extent that such dividends remain unpaid, and for such other and further relief as to the Court may seem just and proper.

Dated December 6, 1927.

William R. Begg, Solicitor for Plaintiff. Office & P. O. address: 24 Broad Street, Borough of Manhattan, New York City.

To Pierce & Greer, Esqs., Attorneys for Defendant Wabash Railway Company, 37 Wall Street, New York City; Hughes, Rounds, Schurman & Dwight, Esqs., Attorneys for Defendants Gerald V. Hollins, Shirley P. Austin, George R. Leslie, and Earl Krapp, 100 Broadway, New York City; Taylor & Roberts, Esqs., Attorneys for Defendants Myron S. Hall, H. W. Cohu, and La Motte Cohu, 56 Pine Street, New York City; Davis, Wagner, Heater & Holton, Esqs., Attorneys for Defendant William Fraser Dickson, 120 Broadway, New York City.

[fol. 63] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF WILLIAM R. BEGG IN SUPPORT OF MOTION

STATE OF NEW YORK,
County of New York, ss:

William R. Begg, being first duly sworn, on oath deposes and says:

1. I am the solicitor for the above-named plaintiff, John C. Barclay. On Wednesday, November 30, 1927, defendant Wabash Railway Company declared a dividend of five per cent on its Five Per Cent Convertible Preferred Stock B out of the net earnings of said defendant for 1927, payable February 6, 1928, to holders of such stock of record at the close of business on December 31, 1927. The declaration of [fol. 64] said dividend has been announced in the press and said dividend will be paid by said defendant on February 6, 1928, unless payment thereof is enjoined by this Court.

2. The net earnings of the defendant Wabash Railway Company, after deducting all operating expenses, rentals, taxes, interest, hire of equipment and all other fixed or prior charges, which constituted surplus and were available for dividends for the fiscal years ended December 31, 1916, to December 31, 1926, both inclusive, were as follows:

1916	$5,390,908	
1917	4,427,105	
1918	5,668,339	
1919	2,548,951	(deficit)
1920	7,369,827	(deficit)
1921	2,017,576	
1922	1,210,388	
1923	5,410,873	
1924	5,474,949	
1925	7,946,438	
1926	8,217,427	

3. In the fiscal years below mentioned there were outstanding of defendant Railway Company's Five Per Cent

Profit Sharing Preferred Stock A (hereinafter called "Preferred Stock A") the number of shares below stated:

1916	462,000	shares
1917	462,000	"
1918	594,645	"
1921	650,984	"
1922	662,782	"
1923	668,376	"
1924	678,850	"
1925	693,058	"
1926	693,330	"

[fol. 65] 4. In every one of the fiscal years above mentioned, except the years ended December 31, 1919, to December 31, 1922, both inclusive, the defendant Wabash Railway Company had available for dividends surplus net earnings more than sufficient to pay in full the preferential five per cent dividend on said Preferred Stock A. In the years ended December 31, 1921, and 1922 said defendant had surplus net earnings available for the payment of said preferential dividends on the Preferred Stock A in part but not in full. In the years ended December 31, 1919 and 1920 said defendant had no net earnings.

5. Out of its surplus net earnings for the fiscal year 1916 the defendant Railway Company paid one per cent only on account of the preferential dividend upon its Preferred Stock A. Out of its surplus net earnings of 1917 it paid only four per cent on account of said preferential dividend on such stock. It paid no dividend on said Preferred Stock A out of the surplus net earnings available for such dividend for the years 1918, 1921, 1922, 1923 and 1924. Out of its surplus net earnings for the year 1925 it paid four per cent on account of said preferential dividend and since 1925 has paid such preferential dividend in full.

The facts above stated with respect to the net earnings of the defendant Railway Company available for dividends for the fiscal years mentioned and with respect to the number of shares of Preferred Stock A of said defendant outstanding in each year and the amount paid out by the defendant in each year on account of preferential dividends on said

Preferred Stock A have been taken for the years 1916, 1917, [fol. 66] 1925 and 1926 from Moody's Manual of Railroads and for all the other years from Poor's Manual of Railroads. These Manuals are standard publications in general use for statistical purposes and are generally relied upon as accurate.

Annexed hereto marked Exhibit A is a schedule, based on the facts above stated, showing in tabular form the surplus net earnings available in each fiscal year, other than 1919 and 1920, for dividends, the number of shares of Preferred Stock A outstanding in such year, the amount required to pay in full the preferential dividend of five per cent for such year on said Preferred Stock A outstanding in such year, the amount actually paid on account of such preferential dividend in such year and the amount earned on account of such dividend in such year but not paid.

William R. Begg.

Sworn to before me this 6th day of December, 1927. Redmond F. Kernan, Jr., Notary Public, New York County, No. 462. New York County Register's No. 8067A. Certificate filed in Kings County No. 222. Kings County Register's No. 8376. Commission expires March 30, 1928.

EXHIBIT "A" TO AFFIDAVIT OF W. R. BEGG

Year	Net earnings available for dividends	Shares of preferred A outstanding	Preferential dividend requirement, preferred A	Dividends paid	Dividends earned but not paid
1916	$5,390,908	462,000	$2,310,000	$462,000	$1,848,000
1917	4,227,105	462,000	2,310,000	1,848,000	462,000
1918	5,668,339	594,645	2,973,225	Nothing	2,973,225
1921	2,017,576	650,984	3,254,920	Nothing	2,017,576
1922	1,210,388	662,782	3,313,910	Nothing	1,210,388
1923	5,410,873	668,376	3,341,880	Nothing	3,341,880
1924	5,474,942	678,850	3,394,250	Nothing	3,394,250
1925	7,946,438	693,058½	3,465,292	2,585,361	879,931
Total preferential dividends earned, but unpaid					$16,127,250

[fol. 67] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF MYRON S. HALL IN OPPOSITION TO MOTION

STATE OF NEW YORK,
County of New York, ss:

Myron S. Hall, being duly sworn, on oath deposes and says:

(1) I am a defendant in this action and represent the firm of Myron S. Hall & Company, the holders of 2197 shares of preferred stock "B" of the defendant Railway Company.

(2) Annexed hereto and made a part hereof marked Exhibit "A" is a schedule showing in tabular form (a) the surplus net earnings of the Railway Company for the years 1916-1926 inclusive, after allocation of $5 per share to the [fol. 68] number of shares of preferred stock "A" outstanding in each of said years; (b) the number of outstanding shares of preferred stock "B" in each of said years; (c) the amount of money necessary to have been earned to pay $5 per share on outstanding preferred stock "B" in each of said years; (d) the total amount of money actually earned up to $5 per share on the outstanding shares of preferred stock "B" in each of said years; (e) the amount of money actually earned on each share of outstanding preferred stock "B" in each of said years, including statement of dividends paid and unpaid.

The figures and facts contained in said Exhibit "A" are from the official financial statements of the defendant Railway Company.

(3) There are now outstanding 24621 shares of preferred stock "B" on which the full dividend of $5 in a fiscal year amounts of $123,105. For the fiscal year 1927 a dividend of $5 has been declared and paid to the holders of preferred stock "A." A dividend of $5 on the outstanding shares of preferred stock "B" was declared by the directors of the defendant Railway Company on November 30th, 1927, payable February 6th, 1928. This dividend amounts to $123,105.

(4) The surplus of the defendant Railway Company as of January 1, 1927, was approximately $38,000,000. The current net earnings of the defendant Railway Company are running at the rate of well over $100 per share on the said outstanding shares of preferred stock "B"; this is after deducting payment from the net earnings $5 per share on outstanding preferred stock "A." (Standard Statistics report current net earnings on preferred stock "B" [fol. 69] of $118 per share). The claim of the plaintiff for the payment of preferential dividends on the preferred stock "A" for prior years 1916-1925 inclusive totals, according to the tabulation annexed to the affidavit of Mr. William R. Begg on this application, $16,127,250.

It is apparent from the foregoing that no irreparable injury will result to the plaintiff by the payment of the dividend of $123,105 on the outstanding shares of preferred stock "B" as declared by the directors of the defendant Railway Company, payable February 6th, 1928. This case is now at issue and can be heard and definitely determined within the next few months. There exists no substantial equitable reason for the granting of an interluctory injunction restraining the payment of the dividend on the preferred stock "B" and the failure to issue such an injunction will not jeopardize the payment of dividends for prior years on preferred stock "A" in the event that the plaintiff's claim in this respect is established.

On the other hand the granting of an interlocutory injunction will not only hold up the payment to the holders of the "B" stock of the dividend declared thereupon as aforesaid, but in my opinion will have the effect of depreciating the market value of the said "B" stock and thus substantially damage the owners thereof.

Myron S. Hall.

Sworn to before me this 14th day of December, 1927.
Mary Monahan, Notary Public, New York County,
No. 815. Kings County No. 729.

[fol. 70]

EXHIBIT "A" TO AFFIDAVIT OF M. S. HALL

Wabash Railway Company

	(a) Actual net earnings after allocation of $5 per share to "A" shares	(b) Outstanding "B" shares	(c) Amount necessary to have been earned to pay dividend of $5 per share on outstanding "B" shares	(d) Actual net earnings on outstanding "B" shares	(e) Amount earned per share on outstanding "B" shares
1916	$2,996,498	487,261	$2,436,305	$2,436,305 no dividend paid	$5.00 not paid
1917	1,862,045	487,281	2,436,406	1,862,045 "	3.83 "
1918	0	221,991	1,109,956	0 "	0 "
1919	0	167,540	837,702	0 "	0 "
1920	0	127,594	637,972	0 "	0 "
1921	0	109,314	546,572	0 "	0 "
1922	0	85,718	428,592	0 "	0 "
1923	2,068,993	74,530	372,652	372,652 "	5.00 "
1924	2,080,699	53,982	269,912	269,912 "	5.00 "
1925	4,481,146	26,521	133,607	133,607 "	5.00 "
1926	4,759,062	25,002	125,010	125,010 paid as dividends	5.00 paid
				$5,074,521—total net earned but not applied to dividends on "B" stock.	

[fol. 71] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION TO DISMISS COMPLAINT

And now comes William F. Dickson, a defendant in the above cause, and moves the court to dismiss the bill of complaint filed in this cause, because said bill does not state any matter of equity entitling the plaintiff to the relief prayed for, nor are the facts as stated therein sufficient to entitle the plaintiff to the relief prayed for against the defendants or any of them or, in particular, against the defendant Wabash Railway Company.

Wherefore, defendant prays the judgment of this court whether he shall further answer, and that he be dismissed with his costs.

Davis, Wagner, Heater & Holton, Solicitors for Defendant William F. Dickson, 120 Broadway, Borough of Manhattan, City of New York. Arnold L. Davis, of Counsel.

[fol. 72] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER WITHDRAWING MOTION TO DISMISS COMPLAINT

It is hereby stipulated and agreed by and between the undersigned that the motion to dismiss the complaint herein, notice of which was heretofore served and filed herein on behalf of the defendant, William Fraser Dickson, may be withdrawn without prejudice and the said defendant permitted to answer the complaint herein, and that an [fol. 73] order to this effect may be entered hereon without further notice.

Dated New York, December 22, 1927.

Wm. R. Begg, Attorney for Plaintiff. Pierce & Greer, Attorneys for Defendant Wabash Railway Company. Taylor & Roberts, Attorneys for Defendant Myron S. Hall et al. Hughes, Rounds, Schurman & Dwight, Attorneys for Defendant Gerald V. Hollins et al. Davis, Wagner, Heater & Holton, Attorneys for Defendant William Fraser Dickson.

So ordered December 28, 1927. F. A. Winslow, U. S. D. J.

[fol. 74] In United States District Court

[Title omitted]

Order that Motion for an Interlocutory Injunction be Considered One for Decree on Pleadings

Pursuant to the suggestion of this Court and to the agreement between counsel made in open court December 23, 1927, and upon the withdrawal by the defendant William Fraser Dickson of his motion to dismiss the complaint herein and upon the service of his answer to said bill of complaint it is hereby requested by all parties hereto that the Court consider the motion made by the plaintiff before it on December 23, 1927, a motion for decree on the pleadings rather than a motion for an interlocutory injunction [fol. 75] as stated in the Notice of Motion.

Dated December 28, 1927.

Wm. R. Begg, Solicitor for Plaintiff. Pierce & Greer, Attorneys for Defendant Wabash Railway Company. Taylor & Roberts, Attorneys for Defendant Myron S. Hall et al. Hughes, Rounds, Schurman & Dwight, Attorneys for Defendant Gerald V. Hollins et al. Davis, Wagner, Hunter & Holton, Attorneys for Defendant William Fraser Dickson.

So ordered December 28, 1927. F. A. Winslow, U. S. D. J.

[fol. 76] In United States District Court

[Title omitted]

Decree Dismissing Bill of Complaint

This cause coming on to be heard on the motion of the plaintiff John C. Barclay for an interlocutory injunction as prayed in the plaintiff's bill of complaint; and the plaintiff

having in open court agreed to withdraw said motion and instead to treat his said motion as one for a final decree on the bill of complaint and the answers filed thereto by the defendants, provided the intervener, William Fraser Dickson, would withdraw his motion to dismiss the complaint and file an answer substantially similar to the answer already filed by Wabash Railway Company, and thereafter the defendant, William Fraser Dickson, having withdrawn his motion to dismiss the bill of complaint and having filed such an answer; and thereupon all parties having agreed by written stipulation dated and filed in this Court on De-
[fol. 77] cember 28, 1927, that the cause be submitted for final decree on the bill of complaint and the answers thereto of the defendants, and having heard William R. Begg in support of a motion for decree in favor of the plaintiff, and Charles E. Hughes, Waithrop Taylor and Arnold L. Davis in support of a motion for decree in favor of the defendants dismissing the complaint on the merits; and the Court having duly considered the cause and being fully advised in the premises and having filed his opinion herein, now upon motion of counsel for the defendants, it is accordingly

Ordered, adjudged and decreed that the bill of complaint of the plaintiff be and the same is hereby dismissed on the merits.

Francis A. Winslow, United States District Judge.

[fol. 79] In United States District Court, Southern District of New York

In Equity. No. 43-298

John C. Barclay, Plaintiff,

against

Wabash Railway Company, Myron S. Hall, H. W. Cook, Le Motte T. Cobb, Gerald V. Hollins, Shirley P. Austin, George R. Leslie, Earl Krupp, and William F. Dickson, Defendants

Appearances:

Wm. R. Begg, Solicitor for Plaintiff (Hornblower, Miller & Garrison, of Counsel);

Charles E. Hughes, Winslow S. Pierce, and F. C. Nicodemus, Jr., Counsel for Defendant Wabash Railway Company;

Charles E. Hughes, Counsel for Defendants Gerald V. Hollins, Shirley P. Austin, George R. Leslie, and Earl Krapp;

Davis, Wagner, Heater & Holton, Solicitors for Defendant William Fraser Dickson (Arnold L. Davis of Counsel);

Winthrop Taylor, Counsel for Defendants Myron S. Hall, H. W. Cohu, and La Motte Cohu.

OPINION

WINSLOW, D. J.:

[fol. 79] This is a suit by John C. Barclay, as a holder of Five Per Cent Profit Sharing Preferred Stock A of the Wabash Railway Company, suing on behalf of himself and other holders of Preferred Stock A to obtain a decree adjudging that "the holders of said Preferred Stock A of the Railway Company are entitled to receive preferential dividends up to the amount of five per cent for each fiscal year from 1915 to 1926, inclusive, to the extent that such dividends were earned in such fiscal years, but were unpaid,—but not in excess of five per cent for any fiscal year,—before any dividends be paid by the Railway Company upon any other class of its stock," etc.

The matter originally came on for hearing on plaintiff's motion for an interlocutory injunction restraining the Railway Company, etc., pending the determination of the suit, from declaring or paying any dividends upon the Preferred B stock of the Company, or any dividends on the Common Stock unless there shall have first been paid all of the preferential dividends at the rate of five per cent in each fiscal year upon its Preferred Stock A from the date of the organization of the Railway Company down to and including the fiscal year 1926 to the extent that the Railway Company has had net earnings available for the payment of such dividends and to the extent that such dividends remain unpaid.

On the argument for interlocutory injunction, pursuant to the suggestion and the agreement between counsel and with the Court's approval, it was stipulated that the inter-

vening defendant Dickson might serve an answer substantially the same as the answer interposed by the Railway Company, whereon the cause would stand submitted on the [fol. 80] pleadings. Such answer was forthwith served, and all parties now move for final decree on the undisputed facts.

Diversity of citizenship exists between the plaintiff and defendants. The Wabash Railway Company was organized under the Laws of the State of Indiana on or about October 22, 1915, pursuant to an "Act of the General Assembly of the State of Indiana approved March 3, 1865." The Railway Company operates a railway system within the States of Ohio, Illinois, Indiana, Iowa and Missouri. Under its certificate of incorporation, three classes of stock have been issued, which may be referred to as (1) Five Per Cent Profit Sharing Preferred Stock A; (2) Five Per Cent Convertible Preferred Stock B; and (3) Common Stock.

The Preferred Stock B is, by its terms, convertible into Five Per Cent Profit Sharing Preferred A (hereinafter called "Preferred Stock A"), and Common Stock of the Railway Company at the rate of one-half share of Preferred Stock A and one-half share of Common Stock for each share of Preferred Stock B.

The plaintiff is the owner and holder of 100 shares of the par value of $100 each of said Preferred Stock A. Defendants Hall, Cohu and Cohu are the owners and holders of Preferred Stock B (par value $100 each). The defendants Hollins, Austin, Leslie and Krapp are the owners of Common Stock (par value $100 each). These defendants are made parties defendant, respectively, as representatives of the holders of Preferred Stock B, and of the Common Stock.

The rights of the three classes of the stock of the Rail- [fol. 81] way Company to dividends are set forth in Article "Fourth" of the certificate of incorporation annexed to the complaint, and also in the certificates issued by the Railway Company for the several classes of stock, copies of which are also annexed. The certificate of incorporation provides:

"Fourth. The Five Per Cent Profit Sharing Preferred Stock A shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent before any dividends shall be paid upon any other stock of this

corporation, but such dividends on the Five Per Cent Profit Sharing Preferred Stock A shall be non-cumulative. After the payment or the setting apart in any one fiscal year of five per cent dividends upon the Five Per Cent Convertible Preferred Stock B and upon the Common Stock of this corporation, the Five Per Cent Profit Sharing Preferred Stock A shall be entitled to receive additional dividends at the same rate per cent as any further or additional dividends which may be declared in that year upon such Common Stock, * * *"

No dividends were declared or paid by the Railway Company upon its said Preferred Stock A during the period from 1915 until January 29, 1917, on which date the Railway Company declared and paid a dividend of 1% upon its said Preferred Stock A, and a like dividend of 1% thereon quarterly thereafter to and including April 30, 1918. From April 30, 1918, to May 25, 1925, no dividends were paid upon the Preferred Stock A. On May 25, 1925, the Railway Company paid a quarterly dividend of one and one-quarter per cent upon its Preferred Stock A and a like dividend quarterly thereafter to date, such amount representing dividends of five per cent in each fiscal year since [fol. 82] May 25, 1925, upon said Preferred Stock A.

The answer admits balances of net earnings in certain non-dividend periods over expenses and prior charges, but denies that such net earnings could, within the sound discretion of its directors, have been distributed to stockholders, and avers that its entire surplus earnings for all of the periods, not actually distributed to stockholders and not reserved for working capital or necessary corporate requirements, has been actually appropriated to, and is now represented by fixed and permanent improvements, etc.

Paragraph "Ninth" of said complaint alleges that:

"The earnings of each fiscal year available for dividends on said Preferred Stock A of the Railway Company in each year in which the Company declared no dividends or declared dividends of less than five per cent on said Preferred Stock A, were retained by the Railway Company and carried to its surplus account and used for additional working capital and for other purposes."

It is further alleged that during the period the aggregate of preferential dividends of five per cent in each fiscal year upon the Preferred Stock A to the extent that the Railway Company had in each fiscal year during the period net earnings available for the payment of such dividends amounted to more than $16,000,000, in excess of the dividends declared and paid by the Railway Company upon said Preferred Stock A, but that (Paragraph "Tenth," Complaint)

"all of said sum of $16,000,000 available for such dividends, but unpaid therefor, was carried to the surplus of the Rail- [fol. 83] way Company and used for additional working capital and for other proper corporate purposes."

This is admitted by the answer, except it denies the availability of such surplus for dividends on Preferred Stock A.

The Railway Company paid no dividends upon its Preferred Stock B from its organization until April 1, 1927, on which date the Railway Company paid a dividend of five per cent upon its Preferred Stock B, but no dividend thereon has been paid since, and no dividends have been paid on its Common Stock.

And it is alleged that the Railway Company threatens to, and will unless restrained, at once inaugurate the payment of regular dividends upon its Preferred Stock B and upon its Common Stock out of its earnings or surplus without having first made good and paid out of such surplus full preferential dividends of five per cent in each fiscal year upon its Preferred Stock A to the extent that such preferential dividends were earned in each fiscal year, but were not paid in full, and it is alleged that such contemplated act will deprive the holders of the said Preferred Stock A of the dividend rights inhering to said Preferred Stock A and diverting from said Preferred Stock A net earnings available for said preferential dividends thereon which were not paid.

The answers admit all of the material allegations of the complaint, except that they deny that the earnings of the Railway Company in non-dividend periods which were used for permanent improvements and additions to the Railway Company's property and carried into surplus, were available for dividends. The answer avers that the Railway

[fol. 84] Company is free in any fiscal year in which dividends amounting to 5% have been paid upon the Preferred Stock A, to pay dividends on Preferred Stock B up to 5%, and set apart or declare dividends on the Common Stock, and that such payments are unrelated to payment of dividends upon Preferred A Stock in prior years.

The plaintiff, on his part, by moving for final decree, admits many other allegations of the Railway Company's answer, including the allegation:

"that its entire surplus earnings of all periods since the incorporation of the Railway Company not actually distributed to stockholders and not reserved for working capital or necessary corporate requirements has been actually appropriated to and is now represented by fixed and permanent improvements and additions to the property and equipment of the Railway Company, to enable it adequately to discharge its public duties, to protect its property, and that no part of such alleged surplus is represented by any cash or liquid fund or by any accumulation of cash assets available for dividends."

The fundamental question to be determined is whether it be true, as asserted by the plaintiff, that the holders of the non-cumulative Preferred Stock A of the Railway Company are vested with an absolute right to preferential dividends up to five per cent in each fiscal year to the extent that the Railway Company has in such year net earnings available for such dividends, and whether this right attaches to such earnings if such declared dividends are not adequate.

There is no contention that the directors have not acted in good faith and with reasonable regard for the needs [fol. 85] of the corporation. Good faith is not now in issue. The declaration of dividends is a matter of sound discretion of the directors acting in good faith. This general rule is applicable alike to Common Stock as well as Preferred Stock and is subject to the proviso only that no statute limits or controls their action or valid contract places an obligation upon them to do otherwise.

The legislature of Indiana (Act, Feb. 28, 1893) made special provisions for preferred stock issued by industrial and other corporations. But this statute by its express

terms is inapplicable to any Company which by existing law is authorized to issue preferred stock. The defendant Railway Company was incorporated under a different statute (Act of March 3, 1865), providing for the creation of railroad corporations in reorganization (Burns' Stat. 1914, Secs. 5333-5339). The statute under which the Railway Company is incorporated authorizes the corporation to establish preference in respect to dividends in favor of different classes of stock and to secure the same in such manner and to such extent as the corporation may deem expedient. The lawful discretion of the Board of Directors is unfettered by statute.

The plaintiff further contends that the holder of Preferred A Stock is entitled to preferential dividends as a matter of right under his contract, and that the words "non-cumulative" imply but one condition, namely, that the Railway Company shall have net earnings in any particular year available for the preferential dividends for such year. I do not understand that to be the rule here applicable. If the discretion of the directors be exercised within reason [fol. 86] and the profits which might otherwise be available for dividends be used to improve and equip the corporate property, that discretion, unless limited by valid contract, will not be interfered with.

Paragraph "Fourth" of the certificate of incorporation provides for a non-cumulative "dividend." If a dividend is not declared in any given year, or if less than five per cent. is so declared, a debt for the undeclared dividend is not thereby created. The valid declaration of a dividend by the Board of Directors creates a debt, but the mere ascertainment of net profits does not create such an obligation. The dividend preference not being cumulative, but only preferential "in each fiscal year up to the amount of five per cent before any dividend shall be paid upon any other stock of this corporation," etc., an undeclared dividend is not to be piled up or accumulated so that payment of the accumulation is a condition precedent to the declaration of dividends on subordinate issues. If there were doubt in my mind as to the status of this Preferred A Stock, the case of N. Y. Lake Erie & Western R. R. Co. v. Nickals, 119 U. S. 296, would resolve that doubt and be decisive. See also Continental Ins. Co. v. U. S., 259 U. S. 156. I agree with

counsel that the latter case is authority for the proposition that there is no right to dividends which are dependent upon a declaration and payable out of the profits of a particular year, unless they are declared by the directors in the proper exercise of their discretion.

Counsel for defendants have pertinently cited the decision of Judge Crump in Norwich Water Power Co. v. Southern Ry. Co., 11 Virginia Law Register (N. S.) 203, where the precise questions here at issue are exhaustively discussed. [fol. 87] The learned Judge in substance holds that, as a general proposition,

"where the dividends are made non-cumulative, the presumed intention is that unpaid dividends in any one or more years were not to accumulate, but, if they were not declared and paid as dividends in any one year, they were lost to stockholders, * * * Where the dividends are declared to be non-cumulative, that phrase carried with it the general idea that the dividends, if not declared and paid within any one year although earnings exist for that year, are lost to the preferred stockholders; that is that non-cumulative means that the right to the dividend is measured by the Board of Directors in any one year, and the failure to declare the dividend in any one year prevents it from accumulating as a further charge upon the earnings of the company then existing or which may be subsequently acquired."

The learned Judge adds (and I think it may not be questioned) that this general rule may be modified by the charter. Nor will it be questioned that the rule might be controlled by statute.

The contract in the instant case does not, to my mind, fetter the sound discretion of the directors nor give the preferred stockholders a continuing, accumulating obligation or liability, which must ultimately, at all events, be discharged. No absolute right exists to resort to earnings of prior years for undeclared dividends. Any other view in the cause would necessitate utter disregard of the reasonable intent and meaning of the language of the non-cumulative provision.

I think the citations of authorities that at first blush seem to run counter to the expressed view, tend, rather, to sup-

port my conclusion, or are distinguishable from the case at [fol. 88] bar. In Collins v. Portland Elec. Power Co., 12 Fed. (2d) 671, at p. 675, the Court held (citing 14 C.J. 421), that

"where the dividends are non-cumulative, and no profits are made in a particular year, the preferred 'stockholders are not entitled to have the dividends for that year made up out of the profits made in subsequent years.' Conversely, it follows that, where profits are made in a particular year, and they are not devoted to some corporate purpose, there is no reason why directors may not in a subsequent year declare dividends and pay them."

In that case, the directors did declare a dividend for an antecedent year from available surplus profits which had not been used for corporate purposes. In the case at bar, the directors have not declared the sought for dividend, and the sum alleged to have been available for such dividend has been "used for additional working capital and for other proper corporate purposes." (Bill of Complaint, par. "Tenth".) As to whether the directors of the defendant Railway Company may have had the power to declare a dividend out of earnings of a prior year, instead of using the funds for other corporate purposes, it is not now necessary to determine. They did not do so.

Wood v. Levy, 47 Hun. 550, cited by plaintiff, rests upon the certificate which the Court held "places the question of these (stockholders) rights beyond the discretion of the directors" * * *, and thus it is not governed by the rule in New York, &c. v. Nickals (supra).

Burk v. Gas &c. Co., 123 Pac. 857, dealt with what was really a guaranteed dividend.

[fol. 89] The various citations by plaintiff of cases arising in New Jersey bear upon statutes of that state controlling the action of directors.

The plaintiff erroneously assumes that the Indiana statute, enacted in 1893, and similar to that of New Jersey, is applicable. As already stated by its very terms, the Indiana statute of 1893 is not applicable to this railroad corporation organized under a prior statute.

I am of the opinion that in the instant case, the non-cumulative preferred dividend is not a fixed charge upon net earnings.

The case having been submitted on the pleadings on motion for final decree, it is adjudged, in accordance with this opinion, that a final decree issue in favor of the defendants dismissing the bill on the merits.

New York, January 12, 1928.

Francis A. Winslow, U. S. District Judge.

[fol. 90] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION OF WILLOUHBY COMPANY, INTERVENOR

To the Honorable Judges of the District Court of the United States, For the Southern District of New York:

The petition of the Willoughby Company, a corporation organized and existing under and by virtue of the laws of the State of Delaware, and citizen of said State, having its principal office in the City of Wilmington in said State, humbly complaining of John C. Barclay, plaintiff, and Wabash Railway Company, Myron S. Hall, H. W. Cohu, LaMotte Cohu, Gerald V. Hollins, Shirley P. Austin, George R. Leslie, Earl Krapp and William Fraser Dickson, defendants in the above cause, would show unto your Honors that John C. Barclay, plaintiff, did, on the 16th day of November, A. D. 1927, file his bill in this cause, wherein [fol. 91] he alleged that he was a holder of 5% profit-Sharing Preferred Stock A of Wabash Railway Company, and brought this suit on his own behalf and on behalf of other holders of said Preferred Stock A, to obtain a decree adjudging, inter alia, that

"the holders of said Preferred Stock A of the Railway Company are entitled to receive preferential dividends up to the amount of 5% for each fiscal year from 1915 to 1926 inclusive, to the extent that such dividends were earned in such years, but were unpaid (but not in excess of 5% for any fiscal year), before any dividends be paid by the Railway Company upon any other class of its stock"

and enjoining the Railway Company—

"from declaring or paying any further dividends upon its Preferred Stock B or any dividends upon its Common Stock until after all preferential dividends at the rate of 5% in each fiscal year upon its said Preferred Stock A, from the date of the organization of said Company down to and including the fiscal year 1926 to the extent that the Railway Company has had net earnings available for the payment of such dividends and to the extent that such dividends remain unpaid, shall have been paid to the holders of said Preferred Stock A."

That the individual defendants were the owners of Preferred Stock B and Common Stock of said Railway Company, as set forth in the bill filed and were joined as representatives of the two classes, to-wit, Preferred B stockholders and Common stockholders.

That the defendant, William Fraser Dickson, became such by intervention and that all of said defendants have [fol. 92] filed their answers denying the claims of plaintiff, and the cause coming on to be heard on an application for interlocutory injunction to restrain the payment of a 5% dividend on the Preferred Stock B declared by the directors of the Railway Company subsequent to the commencement of the suit, and payable on February 6th, 1928, to stockholders of record December 31st, 1927, by arrangement of the parties at the hearing the cause was submitted for final decree upon the bill of complaint and the answers of the respective defendants, including an answer by intervenor Dickson.

That your petitioner was not advised of the hearing until after the same has been had and the case submitted to this court. That it advised with counsel and was preparing to intervene in this cause, when it was announced that the final decision had been handed down.

That your petitioner is the owner of seven hundred (700) shares of the 5% Profit-Sharing Preferred Stock A of the Wabash Railway Company and desires to intervene in this cause and become a party plaintiff therein, to prosecute this cause in subordination to and in recognition of the propriety of the main proceeding, and to adopt the bill filed by the plaintiff herein as its bill, and to participate in

all proceedings in this cause as fully as the original plaintiff, John C. Barclay.

Your petitioner therefore prays for leave to file this petition of intervention and to be made a party to this cause as joint plaintiff herein, as fully and entirely as if named [fol. 93] as one of the original plaintiffs in the bill filed herein.

And it will ever pray, &c.

Joseph S. Clark, Solicitor for Willoughby Co., Intervenor, 1529 Walnut St., Philadelphia, Pa. Clark, Clark, McCarthy & Wagner, of Counsel.

Duly sworn to by Charles A. Pearson, Jr. Jurat omitted in printing.

[fol. 94] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER JOINING WILLOUGHBY COMPANY AS PARTY PLAINTIFF

This cause coming on to be heard on the application of the Willoughby Company, intervenor in this suit, to be made a party plaintiff, and the petition having been duly considered, and it appearing to the Court that the said petitioner is entitled to be made party as one of the class represented by the original plaintiff, it is

Ordered, adjudged and decreed, that the Willoughby Company, petitioner, has leave to intervene as a party plaintiff in said suit with the same force and effect as though it had been named as one of the original plaintiffs herein, and does hereby adopt as its complaint the bill of complaint of the plaintiff Barclay; such intervention to be in subordination to and in recognition of the propriety of the main proceeding and without prejudice to any proceedings heretofore had in this cause.

January 18, 1928.

Francis A. Winslow, Judge District Court of the United States for Southern District of New York.

[fol. 95] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION AND ORDER FOR LEAVE TO APPEAL.

To the Honorable Judges of the United States Court for the Southern District of New York:

The above-named plaintiffs John C. Barclay and Willoughby Company, conceiving themselves aggrieved by the final decree entered on January 16, 1928, in the above-entitled cause, do hereby appeal from said decree to the United States Circuit Court of Appeals for the Second Circuit for the reasons specified in the assignment of errors filed herewith, and they pray that this their appeal may be allowed and that citation issue as provided by law; and [fol. 96] that a transcript of the record and proceedings and papers upon which said decree was made and entered, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Second Circuit.

And your Petitioner further prays that an order fixing the security to be required of him to perfect his appeal be made.

(Sgd.) Wm. R. Begg, Solicitor for Plaintiff John C. Barclay, 24 Broad St., New York City, N. Y.
Joseph S. Clark, Solicitor for Plaintiff Willoughby Company, 1529 Walnut St., Philadelphia, Pa.

New York City, February 6, 1928.

And now, to wit, on February 8, 1928, it is ordered that the petition be granted and the appeal be allowed as prayed for upon giving bond as required by law in the sum of Two Hundred Fifty ($250) Dollars.

Wm. Bondy, District Judge.

[fol. 97] In United States District Court

[Title omitted]

Assignments of Error

Now come John C. Barclay and Willoughby Company, plaintiffs-appellants, and make and file this their assignment of error to the decree entered in the above cause on January 16, 1930.

1. The District Court of the United States for the Southern District of New York erred in denying the motion of plaintiff John C. Barclay for final decree in his favor upon his bill of complaint and the answers thereto.

2. The District Court of the United States for the Southern District of New York erred in ordering and decreeing the dismissal on the merits of the bill of complaint herein.

[fol. 98] 3. The District Court of the United States for the Southern District of New York erred in entering a final decree dismissing on the merits the bill of complaint herein.

4. The District Court of the United States for the Southern District of New York erred in its interpretation of the word "non-cumulative" as used in the contract which defines the dividend rights of the several classes of stockholders of the Wabash Railway Company.

5. The District Court of the United States for the Southern District of New York erred in holding as follows in its opinion:

"The dividend preferences not being cumulative but only preferential, in each fiscal year up to the amount of 5% before any dividend shall be paid upon any other stock of this corporation, etc., no unbelieved dividend is not to be piled up or accumulated so that payment of the accumulation is a condition precedent to the declaration of dividends on subordinate issues."

6. The District Court of the United States for the Southern District of New York erred in holding that the Board of Directors was vested with authority to pay dividends upon the Preferred B stock before all dividends accrued in prior

years upon Preferred Stock A of said Company are first paid and satisfied.

7. The District Court of the United States for the Southern District of New York erred in holding that the Board of Directors was vested with authority to pay dividends upon the common stock before all dividends earned in prior years upon Preferred Stock A of said Company are first paid and satisfied.

[fol. 99] 8. The District Court of the United States for the Southern District of New York erred in holding that the Preferred A stockholders, whose dividends are non-cumulative, are not entitled because of that fact to insist upon payment of their dividends earned in prior years but which still remain unpaid before dividends may be paid upon Preferred Stock B.

9. The District Court of the United States for the Southern District of New York erred in holding that the Preferred A stockholders, whose dividends are non-cumulative, are not entitled because of that fact to insist upon payment of their dividends earned in prior years but which still remain unpaid before dividends may be paid upon the common stock.

Wherefore plaintiffs-appellants pray that the decree of the District Court of the United States for the Southern District of New York, in this cause entered, be reversed and that a final decree be directed in their favor as prayed in the bill of complaint herein.

Dated New York, N. Y., February 6, 1929.

(Sgd.) Wm. R. Begg, Solicitor for Plaintiff John C. Barclay, 24 Broad Street, New York City, N. Y.
Joseph S. Clark, Solicitor for Plaintiff Willoughby Company, 1329 Walnut Street, Phila., Pa.

[fol. 100] Citation, in usual form, omitted in printing.

[fol. 101] In United States District Court

[Title omitted]

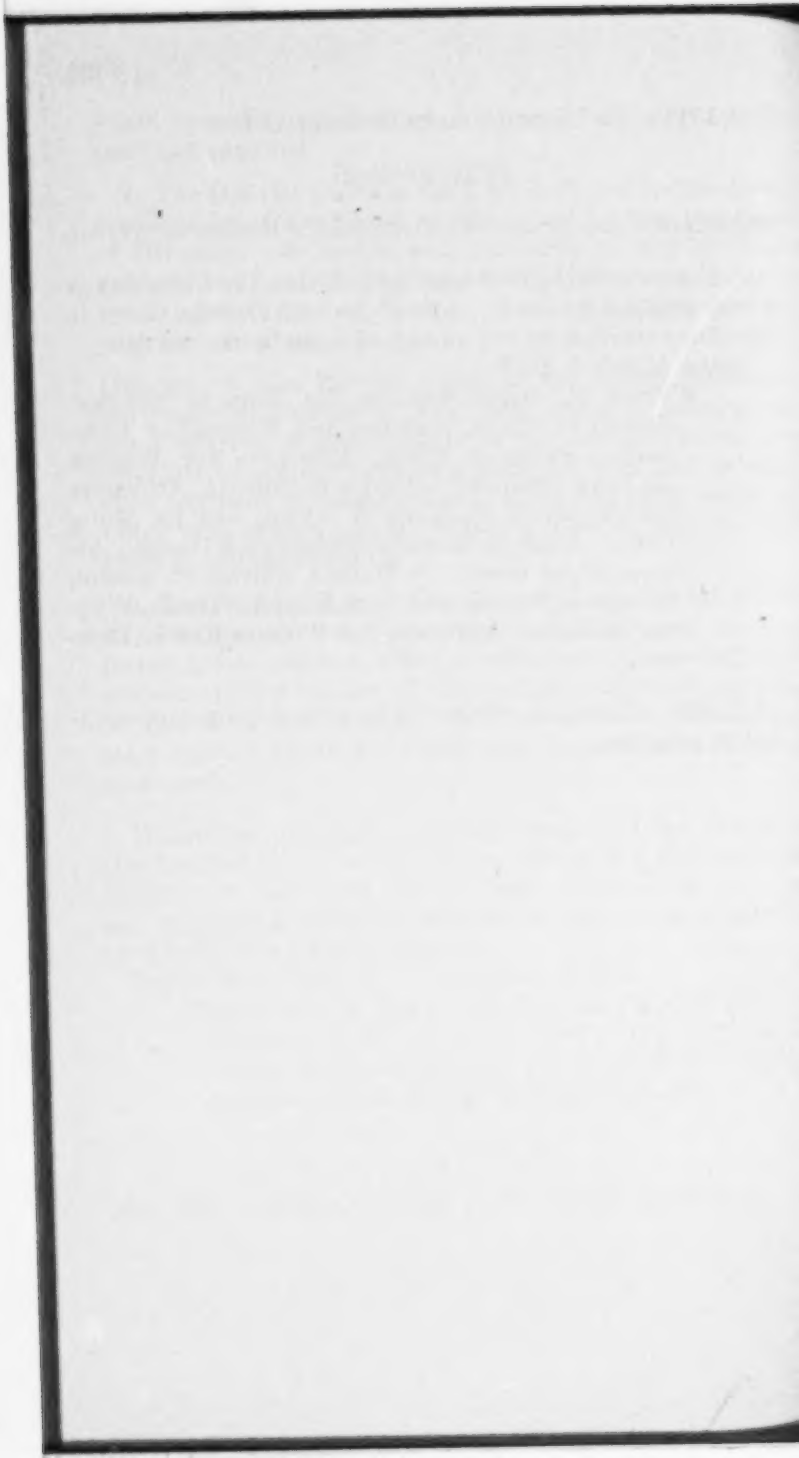
Stipulation Agreeing to Correctness of Record on Appeal.

It is hereby stipulated and agreed, that the foregoing is a true transcript of the record of the said District Court in the above entitled matter as agreed upon by the parties.

Dated March 6, 1928.

William R. Begg, Solicitor for John C. Barclay. Joseph S. Clark, Solicitor for Willoughby Company. Pierce & Greer, Attorneys for Wabash Railway Company. Taylor & Roberts, Attorneys for Myron S. Hall, H. W. Cohn, and La Motte Cohn. Hughes, Rounds, Schurman & Dwight, Attorneys for Gerald V. Hollins, Shirley P. Austin, George R. Leslie, and Earl Krapp. Davis, Wagner & Heater, Attorneys for William Fraser Dickson.

[fol. 102] Clerk's certificate to foregoing transcript omitted in printing.



UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

JOHN C. BARCLAY and WILLOUGHBY COMPANY, Appellants,

against

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, La Motte Cohu, Gerald V. Hollins, Shirley P. Austin, George R. Leslie, Earle Krapp, and William Fraser Dickson, Respondents

Before Manton, L. Hand, and A. N. Hand, Circuit Judges

Appeal from the District Court for the Southern District of New York

Plaintiffs, John C. Barclay and Willoughby Company, sued for an injunction restraining the payment of dividends by the Wabash Railway Company to its junior stockholders. Decree for defendants; plaintiffs appeal. Decree reversed.

Wm. R. Begg, Esq., Joseph S. Clark, Esq., Ellis Ames Ballard, Esq., Solicitors for Appellants; Hornblower, Miller & Garrison, Esqs., Clark, Clark, McCarthy & Wagner, Esqs., Ballard, Spahr, Andrews & Ingersoll, Esqs., of Counsel.

Charles E. Hughes, Esq., Winslow S. Pierce, Esq., F. C. Nicodemus, Jr., Esq., Counsel for Defendant-Respondent Wabash Railway Company.

Charles E. Hughes, Esq., Counsel for Defendants-Respondents Gerald V. Hollins, Shirley P. Austin, Geo. R. Leslie, and Earl Krapp.

Davis, Wagner & Heater, Esqs., Solicitors for Respondent William Fraser Dickson; Arnold L. Davis, Esq., of Counsel.

MANTON, Circuit Judge:

Appellants are owners of Preferred Stock Class A. The appellees Messrs. Myron S. Hall, H. W. Cohu and La Motte T. Cohu are owners of Preferred Stock Class B and the ap-

pellees Gerald V. Hollins, Shirley P. Austin, George R. Leslie, Earl Krapp and William Fraser Dickson own common stock of the appellee Wabash Railway Company, an Indiana corporation organized October 22, 1915. On May 1, 1927, it had outstanding 690,000 shares, of $100 par value, Preferred Stock A and 24,000 shares, par value $100, Preferred Stock B, and 665,000 shares of common stock, par value $100. The certificate of incorporation provided:

"The Five Per cent Profit Sharing Preferred Stock A shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent before any dividends shall be paid upon any other stock of this corporation, but such dividends on the Five Per Cent Profit Sharing Preferred A stock shall be non-cumulative.

The certificates of Preferred Stock A made promise to the holders thereof of the same obligations. No dividend was paid from October, 1915 until January 29, 1917 on which day and quarterly thereafter, a dividend of one per cent on Stock A was paid up to and including April 30, 1918. From that date to May 25, 1925, no dividends were paid on this stock. On May 25, 1925 and quarterly thereafter 1¼% was paid. The complaint alleged that the earnings for each fiscal year available for dividends on Stock A on which the company declared no dividends or declared a dividend of less than 5%, were retained by the company and carried to its surplus account and used for additional working capital or betterments. Further, that during the period from its organization to May 25, 1925, the aggregate of preferential dividends of 5% in each fiscal year upon Stock A, to the extent that the railroad company had in each fiscal year during said period net earnings available for payment of such dividends, amounted to sixteen million dollars in excess of the dividends declared and paid by it on Stock A and it is alleged, all of this sum, available for such dividends, was carried to the surplus of the Railway Company and used for additional working capital and other corporate purposes. That on April 1, 1927, the Railway Company paid a dividend of 5% on its Preferred Stock B out of the earnings of 1926 or some preceding year and that it now threatens to pay regular dividends upon its Preferred Stock B and its common stock without first making good

and paying out of the surplus full preferential dividends of 5% in each fiscal year upon Stock A from the time of its organization to the extent that such preferential dividends were earned in each fiscal year but were not paid in full, thereby depriving the stockholders of Stock A of the dividend rights inhering in said Stock A and diverting from Stock A net earnings available for such preferential dividends thereon which were not paid. The answer alleges that the entire surplus of all periods since the incorporation of the Railway Company not distributed to stockholders and not reserved for working capital or necessary corporate requirements, has been actually appropriated to and is now represented by fixed and permanent improvements and additions to the property.

That this was necessary to enable it to carry on its corporate purposes and that no part of the surplus represented by cash or earnings has been available for dividends. It admits, however, that all sums of over sixteen million dollars were carried to the credit of the surplus account of the Railway Company and still forms a part of the present credit to that account. It is admitted that the certificate of incorporation is as alleged by the plaintiffs and that dividends were paid on Preferred Stock A to the extent alleged. The relief sought by the appellant Barclay is for an interlocutory injunction to restrain the threatened payment of the dividend on Stock B declared after the bill was filed payable February 6, 1928 out of earnings of 1927 and, also, by the appellants to enjoin the payment of dividends on common stock until it shall first have paid the preferential dividends which have been earned in prior years and which have not been paid on Stock A. By stipulation it is agreed that the interlocutory judgment should be deemed and treated as having resulted from a motion for a final decree on the bill and answers filed and the court so treated it, dismissing the bill on the merits. From that decree this appeal is prosecuted.

Recognizing that no dividend, other than in liquidation, may be paid except out of earnings, and that Preferred B and common stockholders may receive dividends only after the preferential dividends given Class A stockholders are paid, the parties differ as to the construction to be placed upon the terms of the preferential contract of Stock A.

What is the intent and extent of this dividend preference we must consider. It is not disputed but that Class A receives preferential dividends in each fiscal year up to the amount of 5%. It must be paid "before any dividend shall be paid upon any other stock of this corporation." At once the issue is presented as to what is meant by "shall be non-cumulative." Appellants' argument is that it means that the dividends each year are dependent upon the earnings of the year; that they, as Preferred A stockholders, are not entitled to receive dividends for any year unless they are earned in the year. Admitting that in past years an aggregate of over sixteen million dollars was earned upon its preferred stock, taking the annual earnings year by year, which might have been paid as Preferred A dividends, the board of directors in the exercise of its discretion, used earnings to pay the cost of additions and improvements to the property and to increase its working capital, and the argument now is, that because of this, Preferred A stockholders have lost all their right to the dividends for the years unpaid. That future earnings may not be appropriated by the board to pay dividends for the years when, although there were profits, no dividend on this class of stock has been declared, is now asserted by the appellees.

Cumulative dividends must be paid regardless of the year in which they are earned, while non-cumulative dividends paid any year are dependent upon the earnings of that year. If not earned in the particular year, the stockholders are not entitled to dividends for that year and the deficiency cannot be made up out of surplus earnings of a subsequent year. But the appellants' argument is that if dividends were earned during any particular year, although not declared by the Board of Directors and even though earnings were used for improvements and betterments if, in a subsequent year, there is a profit, common stockholders under the terms of this certificate, may not share in that profit unless and until dividends have been paid on Preferred Stock A up to the amount of the earnings of the particular year but not to exceed 5% as provided.

Preferred A stock received a dividend credit to the extent of the earnings each year not to exceed 5%. It secured no dividend credit whatever in any year where there were no earnings. A board of directors may deem it unwise

to declare non-cumulative dividends at the end of each year or at any particular time until conditions are favorable for dividend distribution. But in the meantime, the dividend credit in favor of the preferred stockholders increases to the extent of the earnings of each year and against the dividend credit charges are made to the extent that the preferred dividends are declared and paid. The surplus account to the extent of this dividend credit in favor of the Preferred Class A is marked, in a sense, in favor of such stockholders. It cannot be used for the payment of dividends on any stock junior to Preferred A until that credit has been satisfied.

The reported cases, considering this question, are (1) cases in which the right of the board to pay earned but withheld non-cumulative preferred dividends for prior years without reference to the fund from which payment was made; (2) cases in which the right of the board to refuse payment of earned but withheld noncumulative preferred dividends upon demand by the preferred stockholders was presented, and (3) cases in which the right to enjoin payment of dividends on junior stocks until after payment of earned but withheld noncumulative preferred dividends for prior years was presented. The right of the board to declare noncumulative preferred dividends for prior years is not necessarily presented here. But on April 1, 1927, the board did declare a dividend for the year 1926 on Preferred B stock. The certificate of Class A stock makes such stock entitled to receive preferential dividends "before any dividends shall be paid upon any other stock." This language would indicate that the board of directors could not declare dividends on B stock until A stock was fully satisfied as to dividends. Wood v. Lary, 47 Hun. 550, presented the question of whether a board had the right to pay noncumulative dividends at the end of a four-year period during which the dividends were earned year by year and to pay such dividends by issuing bonds of the company. The contract provided as to preferred stockholders that they were "entitled to dividends, not to exceed six per cent, payable semiannually, not cumulative, whenever in any year the net earnings, after payment of all interest charges, shall suffice for payment thereof." No preferential dividends were paid for the years in question,

but during the period dividends were earned and the money was expended for construction account. After the four years, the board met and declared a dividend upon the noncumulative preferred stock payable in bonds. The common stockholders objected, alleging that the preferred dividends were noncumulative and the directors had no right to declare preferred dividends for these prior years. The court held, however, referring to the phraseology of the certificate, that whether or not the directors declared a dividend of these profits earned in each year, the stockholders were entitled to them and their rights therein became fixed and even if the directors made no division thereof, the rights still existed and could not be taken away; that the subsequent compliance by the directors with the terms of the contract in the declaration of a dividend did not infringe upon the provision of the certificate which made the dividends noncumulative. From a very well reasoned opinion, it would appear that if the board at the end of the four year period had undertaken to pay common dividends without first paying and satisfying those earned but unpaid and noncumulative preferred dividends, the preferred stockholders would have had the right to enjoin the payment of such common dividends. It is also noteworthy that at the time of the passage of the dividend resolution and the execution of the mortgage and issue of the bonds, the amount of the net earnings was not in hand in cash, but was in the hands of the corporation as new property in addition to and in excess of the property received by it at the time of the reorganization. In Bassett v. U. S. Cast Iron Pipe & Foundry Co., 74 N. J. Equity, 668, 70 Atl. 929; on appeal, 75 N. J. Equity, 539, 73 Atl. 514, and Moran v. U. S. Cast Iron Pipe & Foundry Co., 95 N. J. Equity, 389, affirmed in 96 N. J. Equity, 698, the board declared dividends on its noncumulative preferred stock for prior years in which such dividends had been earned and a common stockholder sued to enjoin payment and the right of the board to declare and pay these preferred dividends was sustained even against the objection that they were designated "non-cumulative." In Collins v. Portland Electric Power Co., 12 Fed. (2d) 671, where the board declared dividends upon its non-cumulative preferred stock for prior years, which had been earned in those years, the common stock-

holders' suit was to enjoin the payment because the preferred stock was noncumulative and it was declared that the board had such power. In N. Y., Lake Erie & W. R. R. Co. v. Nickals, 119 U. S. 296, the Supreme Court considered dividend rights of preferred stockholders whose dividends were noncumulative and referred to noncumulative dividends as such because they were dependent upon the profits of each particular year and were not to be fastened upon the profits of the succeeding year. In Staples v. Eastern Photographic Materials Co. (1896) L. R. 2 Ch. Div. 303, a stockholder's contract read:

"The holders of the preference shares shall be entitled out of the net profits of each year to a preference dividend at the rate of 10 1 per cent per annum on the amount for the time being paid or deemed to be paid up thereon. After payment of such preferential dividend the holder of ordinary shares shall be entitled to a like dividend at the rate of 10 1 per cent per annum on the amount paid on each ordinary share. Subject as aforesaid, the preference and ordinary shares shall rank equally for dividend."

Lindley, L. J. said:

"Are they (the preferred holders) to have cumulative dividends, or are they to have dividends only according to the share of the profits in each year in which there are profits?"

And again:

"It appears to me that the reference of the dividend to the profits of each year is most marked."

Kay, L. J., in his opinion said:

"I do not find any provision that the holders of preferred shares are to be entitled in any event to a dividend per annum at the rate of 10 per cent. I can only find an indication that out of the profits of each that shall be their share of those profits."

It is apparent that Kay, L. J., felt that if there were profits in each year up to the 10% and the dividends up to that amount among the preferred were not declared in those

years, it would have to be made up before any other dividends would be paid.

In the second class are found preferred stockholders who, in order to sustain a demand for payment of their dividends, are held to a showing that they are entitled to receive the dividends demanded. If the dividends of a prior year are cumulative, delay in the declaration and payment is of no importance; if non-cumulative, the company has a good defense against any demand if not earned. In the absence of an abuse of discretion, the board of directors cannot be forced to pay dividends. In N. Y., L. E. & W. R. R. v. Nickals, supra, preferred stockholders demanded the payment of their noncumulative stock dividends which had been earned in a prior year under a contract and this demand was denied. The contract provided for

"Preferred Stock • • • entitling the holders to noncumulative dividends, at the rate of six per cent per annum, in preference to the payment of any dividend on the common stock, but dependent on the profits of each particular year as declared by the board of directors."

The Supreme Court held that under this contract the dividends were payable as declared by the Board of Directors. It pointed out that the evidence showed that the profits for the year were applied to the objects which were legitimate and proper and as the condition of the company was not such as to make the declaration of the dividend a duty on the part of the directors, there was no basis for the claim to such dividend. Dent v. London Tramways Co., 16 Chan. Div. 344 (1880) referred to in the Nickals case, was a suit by preferred stockholders to secure a declaration that they were entitled to their dividends earned in prior years on a certificate which granted a "preferential dividend of 6 per cent per annum over the present shares of the company dependent upon the profits of the particular year only." The company claimed the right to further postpone the payment of the preferred dividends although they had been earned, and it was held that they must be paid even though they were noncumulative dividends earned in prior years. The company had used the earnings to pay dividends on ordinary shares in place of using them

for betterments and improvements. In Burk v. Ottowa Gas & Electric Co., 87 Kan. 6, 123 Pac. 857, the action was by preferred stockholders against a public utilities corporation and its directors to require an accounting and a decree ordering the directors to declare such dividends from the net profits of the business as should have been declared since January 1, 1906. The certificate of stock provided:

"The preferred stock shall carry a six per cent per annum preferred noncumulative dividend, payable semi-annually on the first day of July and January of each year after January 1, 1906, out of the net profits of the preceding fiscal year, and the pro tanto dividend if such dividend shall fall short of 6 per cent."

In each year from 1906 to 1910 the company made profits which were put into extentions of plant and properties. The trial court found the extensions were "necessary" but did not specifically find that they were necessary for a public utility company to perform its obligations to the public. Reversed on appeal, the trial court was ordered to take further proof. Speaking of the contract, the court said:

"The fair interpretation of the contract between the corporation and the holder of this stock is that, if in any year net profits are earned, a dividend is to be declared. To hold that the board of directors—that is to say, the corporation—has a discretion to declare or not to declare a dividend when it has funds that it can use for the purpose, is to hold that one of the parties to a contract has the option to pay something to the other or not, at its own election, since if the dividend is not declared at the end of the year, the benefits of the accumulated profits are practically lost to these stockholders. Such a construction should be avoided if any other is reasonably open, because it would result in temptation to unfair dealing."

Appellees argue, however, that this case is to be distinguished because of the phrase of the certificate "out of the net profits of the preceding fiscal year" constituted a guaranteed dividend and says that the words are absent in the instant case. The earnings were put into the plant for extensions but the court nevertheless granted relief. In Star

Publishing Co. v. Ball, 192 Ind. 1'3, 134 N. E. 385, which was a suit by a preferred stockholder to enjoin a bond issue and for a decree requiring payment of dividends on stock, the certificate provided:

"Equal noncumulative dividends shall be paid on all outstanding shares of such preferred stock * * * at the rate of five (5) per centum per annum, payable quarterly * * * in each year, when earned and declared out of the funds of the company available therefor, and no dividends shall be paid upon any of the shares of said common stock * * *, until full payment has been made of all dividends declared upon the outstanding shares of preferred stock authorized by such articles of association."

Between 1911 and 1918, the affairs of the company were in such condition that it could have paid 5% preferred dividends in each of the years but no dividends were paid until the company was compelled to by the action of the trial court. In affirming the judgment below, the court said:

"The serious question in our minds is whether the court should not have declared a greater dividend, and whether appellee should not succeed on his cross-error. But at this point we are met with a record which gives us no finding as to the necessary working capital for the year 1918, nor, in fact, for any year."

Further

"Appellant claims that appellee waived his right to dividends by acquiescing in the use of the net earnings and profits of the company in paying the mortgage debt. In this appellant is in error. It merely suspended the appellee's right until there was an excess of earnings over the amount reasonably required to be expended for that purpose."

Thus the claims of the preferred stockholders were sustained where the dividends were noncumulative. The application of the proportion of the earnings, which might have been used for payment of preferred dividends, to pay the debts of the company, operated merely as a suspension or postponement of the right of the preferred stockholders to receive their postponed dividends.

With this understanding of "noncumulative," the sixth holders of Preferred A have not lost their preference dividend rights for prior years and are entitled to have those recognized and the dividend paid before any dividend may be paid on the junior stocks. In Bates v. U. S. Cast Iron Pipe & Foundry Co., 62 N. J. Equity, 466, Dumont v. U. S. Cast Iron Pipe & Foundry Co., 74 N. J. Equity, 668, on appeal in 75 N. J. Equity, 628, and Day v. U. S. Cast Iron Pipe & Foundry Co., 62 N. J. Equity, 666, affd. 63 N. J. Equity, 798, the New Jersey courts dealt with the question of non-cumulative dividends. By a certificate which provided that "The preferred stock shall be entitled, out of any and all surplus net profits, whenever declared by the board of directors, to noncumulative dividends at a rate not to exceed 7 per cent per annum for the fiscal year beginning the 1st day of June, 1899, and for each and every other fiscal year thereafter, payable in preference and priority to any payment of any dividend on the common stock for each fiscal year," it was held that the profits to the extent that they were earned in the prior years belong primarily to the preferred stockholders and in distributing them as dividends, no restriction was imposed upon the board other than as to time or occasion. And even having decided to divide the profits, duty compels discretion and a honest investment upon the directors to discharge the company's obligation to pay the fixed yearly preferred dividends and the before any dividends shall be paid upon the common stock. As to noncumulative dividends, they are to be paid out of the profits of any fiscal year, not more than the percentage fixed by the charter to be paid on such stock for such year. But that does not prohibit the company, after having paid the fixed yearly dividend from, in the same year, declaring and paying additional dividends out of the profits earned in prior years available to dividends for such years and which, but for holding them in reserve for accounts receivable, would have been distributed as dividends in those years. That such profits belong primarily to the preferred stockholders and the directors are in no wise restricted either as to amount, time or occasion when the distribution shall be made. In Collins v. Portland Electric Power Co., supra, the board of directors declared three dividends in 1913 on noncumulative second preferred stock, the first for

the year ending December 31, 1921, the second for the year ending December 31, 1923, and the third for the year ending December 31, 1925, and also a dividend upon common stock for the year ending December 31, 1924. The second preferred stockholders sued to enjoin the payment of common dividends because of non-payment of the second preferred dividends for prior years. The defense contended that the second preferred dividend stockholders for prior years had lost their rights to dividends because, being noncumulative, they were not declared within the year and also because, under the contract, the board was authorized to pay common dividends even though second preferred dividends for prior years still remained unpaid. The common stockholders filed a bill in the second case to enjoin payment of preferred stockholders on the ground that their dividends for prior years were lost because not declared within the several years respectively. The contract provided that

"the dividend upon the prior preference stock of every series and the first preferred stock shall be cumulative, but accumulations of dividends shall not bear interest. The holders of the second preferred stock are entitled to receive, when and as declared, out of the surplus or net profits of the company, dividends at the rate of 6 per cent. per annum payable as the board of directors may determine, before any dividend shall be set apart for or paid upon the common stock. The dividends upon the second preferred stock shall not be cumulative."

It was said on appeal to the Ninth Circuit Court of Appeals that the

"controversy between the parties on this appeal is narrowed to the issue whether dividends upon the second preferred stock are lost if not declared and paid within the year, notwithstanding that there may have been earnings sufficient to pay all or part thereof, or whether the fact that the earnings were made gave to the holders of the second preferred stock a positive right to dividends out of said earnings, with the result that the directors may lawfully declare and pay such dividends in subsequent years."

And it was held that the directors, having declared dividends for the years 1921 and 1922, recognized that the dividends ought to have been paid in those years and that the condition of the company's property and affairs as a whole justified their action in declaring such dividends. In Continental Ins. Co. v. United States, 259 U. S. 156, referred to by appellees, the court considered a suit by common stockholders who, in the distribution of assets on the dissolution of the company, demanded an award in their favor of an amount equal to dividends which the board might have declared upon the common stock in prior years and payment of such award upon any capital distribution to the preferred stockholders. The board of directors had capitalized these dividends. The court held that the common stockholders could not force the board to declare and pay common dividends for prior years even though the dividends had been earned, if the board, in the exercise of its proper discretion, failed to declare and pay such dividends. The right of the board to pay common dividends, which had been earned in prior years, at any time before dissolution was recognized, but the court held that undivided earnings are to be capitalized and distributed on liquidation unless the board of directors has applied them as dividends. No other question of dividend priority was presented for consideration. We are also referred to Norwich Water Co. v. Southern Ry. Co., 11 Va. Law Register (New Series) 202 where the Chancellor held, subject to certain limitations, that a noncumulative preferred stock dividend for any particular year is lost to the preferred stockholders if not declared within the year. He pointed out that a failure to declare dividends within the year results in loss to the preferred stockholders of their right to demand that dividend but not a loss to the directors of their right to pay it. Of course, stockholders never had the right to demand payment within the year and the stockholders in the Norwich case never had such right to demand. The contract provided for the "non-cumulative dividends * * * from the net profits * * * and only when and as such Board shall declare dividends therefrom." The board could postpone the declaration until after the termination of the year. The Chancellor held that the characterization "non-cumulative" did not apply

if, under the contract, the preferred stockholders have the absolute right to their dividends, and that an obligation is imposed upon the company to pay it. He declined to hold that there was an absolute right or obligation under the particular contract. That determination is undoubtedly influenced by the terms of the contract, which the Chancellor considered, which provided for priority in any payment of dividends from the net profits of the company

"as such shall be fixed and determined by the Board of Directors and only when and as such Board shall declare dividends therefrom; but, notwithstanding the preference hereby declared, if, after providing for the payment of dividends for any fiscal year on the Preferred Stock outstanding in such year, there shall remain a surplus of net profits of such year, the Board of Directors may declare and pay dividends upon any other stock of the Company for such year out of such surplus net profits."

Even though it be thought that the decisions on which appellants rely have been controlled by the particular wording of corporate charters and State statutes, yet it can hardly be maintained that any decision of a court of last resort is definitely against appellant's claim. Continental Trust Co. v. United States, supra, seems to be regarded by appellees as supporting their position. But that is not so for the reasons already stated.

It is said that the right to declare and pay dividends to the non-cumulative preferred stock rested with the directors and no longer exists because the earnings of former years which might have been paid to the preferred stockholders have become capital. But where there is arbitrary conduct by directors in withholding payment of dividends, relief may be had against it in a court of equity. If all stockholders may have relief where dividends are arbitrarily withheld, we cannot see why non-cumulative preferred stockholders do not possess similar equities where earnings which might have been applied to dividends on non-cumulative preferred stock have been placed in the capital account and retained there and subsequent earnings not needed for capital are to be distributed to one class of stockholders or other.

Preferred stockholders are not in all respects joint adventurers with common stockholders. Even if having a vote, the control of the corporation is nearly always in the hands of the common stockholders and the directors are thus really chosen by the latter.

It is manifest that if directors, in effect selected by the common stockholders, be given almost unlimited power to retain in the capital account earnings which might have been voted to non-cumulative preferred stockholders and likewise the power to vote dividends to the common stock from earnings in subsequent years without recognition of any deferred prior right of the preferred stockholders, the common stock really secures priority over the preferred stock to the extent of the earnings which have been appropriated for capital. The power to bring about such a result subjects directors to an undesirable temptation to favor the common stockholders, who ordinarily control the corporation, and is not required by the terms of the corporate charter or by judicial authority. Recognition of a deferred credit seems to a majority of the court to be based on considerations of good public policy as well as sound equitable principles. (See article in Vol. 23 Columbia Law Review, p. 357, on "Non-cumulative Preferred Stock" by A. A. Berle, Jr. and note in Vol. 34 of the Yale Law Journal, at p. 657, on "The Rights of Non-cumulative Preferred Stockholders in Undivided Profits.")

The failure of the board of directors to declare Preferred A dividends and the appropriation of the earnings with which they might have been paid to increase the working capital and to pay for construction of extensions and additions, we hold resulted only in granting a dividend credit which, at some postponed date, may be paid to Preferred A stockholders as dividends under the terms of the contract. They are still entitled to receive such dividends and the Board may not pay dividends upon junior stocks until after these earned dividends of Preferred A stock are first paid and satisfied.

Decree reversed.

[Endorsed:] United States Circuit Court of Appeals, Second Circuit. John C. Barclay & ano. vs. Wabash Railway Co. et al. (Copy.) Opinion. Manton, Circuit Judge.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

JOHN C. BARCLAY and WILLOUGHBY COMPANY, Appellants,

against

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, LaMotte Cohu, Gerald V. Hollins, Shirley P. Austin, George R. Leslie, Earle Krapp, and William Fraser Dickson, Respondents

L. HAND, Circuit Judge (dissenting):

The relevant clause of the charter gives the plaintiffs "preferred dividends in each fiscal year up to the amount of five per cent," and the case concerns only the earnings of a current year, not the distribution of accumulations carried over from earlier years. There were undeclared earnings in such years, but they are now in the form of track, equipment and working capital, and in that form they will remain, for the directors do not mean to distribute any of the working capital, obviously the only part which they could. The words, "up to the amount of five per cent," were prima facie used in limitation as well as in grant, and the question is whether the circumstances require us to import an exception. The occasion is that the earlier earnings could have been declared, had not the directors decided that the corporation needed the money for its general operations, a decision which nobody challenges.

If the directors proposed to reduce the working capital accumulated out of past earnings, they would probably be obliged to declare as preferred dividends the amount so withdrawn. That was the situation in Bassett v. U. S. Cast Iron etc. Co., 75 N. J. Eq. 539, and also in Collins v. Portland etc. Co., 12 Fed. (2) 671, (C. C. A. 9), as I understand the facts, although the report is not altogether clear. But in the case at bar the directors still need the working capital which they accumulated out of earlier earnings; the only way in which it can be considered to be distributed is by gratuitously marshalling the proposed common dividend against earlier earnings and using current earnings to make up the deficit so created. That I

submit would be legerdemain. Moreover, since there is no rational distinction between working capital and track and equipment, the result of our decision must be to establish a deferred credit of $16,000,000, which must be declared out of the earnings of later years before the common shares can get anything whatever. There is not the slightest reason to suppose that the preferred shares would have claimed anything of the sort, or that the common shares would have yielded it if they had. Apparently in Day v. U. S. Cast Iron etc. Co., 95 N. J. Eq. 389, the working capital was indeed not reduced and the preferred shares were awarded some part of the earlier earnings, though even this is not entirely clear. But the case was decided by an evenly divided court in which six out of the nine justices voted to deny the claim and where everyone supposed that the New Jersey statute was important, if not determinative. The case is scarcely authority for the position here taken.

Nor are those cases authority where the charter makes the preferred dividends depend only upon earnings, (Wood v. Lary, 47 Hun 550; Burk v. Ottawa etc. Co., 87 Kas. 6). The directors have then no choice and must declare the dividends in the year in which the earnings are made, or as soon as the shareholders demand them. Such cases are outside the general rule laid down in N. Y. L. E. & W. R. R. v. Nickalls, 119 U. S. 296. Again, the majority shareholders may have abused their powers as in Star Pub. Co. v. Ball, 192 Ind. 158, where, moreover, the discussion of the preferred shareholders' rights to a larger dividend than that allowed by the lower court gives as much comfort to the appellees here as to the appellants. In the case at bar both sides agree that the directors must declare the earnings as dividends before the shareholders can become entitled to them, and that their judgment was honestly exercised when they declined to declare them in the past.

What is there then which should induce us to ignore the limitation of the charter, that out of the earnings of any year the preferred dividends shall be limited to five per cent? Nothing but the fact that in past years it was inadvisable in the company's interest to retain what except

for those interests should have been declared. To such contingencies preferred shareholders are as subject as common; they accept them in the character of their investment. We must say that in some way the mere existence of earnings gives them a right, not immediate indeed, for that would be too flagrant a disregard of the language, but as a kind of lien on subsequent earnings when these can be spared. That might be a good sort of investment, but how have they stipulated for it? They have agreed not to claim earnings as such and to limit their rights upon the earnings of any given year. I can see no basis for the interpolation of this added right; it seems to me to violate the basic agreement. None of the considerations which apply to deferred dividends touch it at all; it is a mere gratuity.

The only decision in point, except Day v. U. S. Cast Iron etc. Co., is Norwich Water Co. v. So. Ry. Co., 11 Va. Law Reg. (N. S.) 203, in which, however, though the discussion bears out the view I take, the charter was such as of itself to compel the result. On the other hand, Continental Trust Co. v. U. S., 259 U. S. 156, is not so foreign to the case as my brothers think. If prior earnings retain no earmarks upon dissolution, though they are then a part of the very funds distributed, it would seem that they should not create a lien upon subsequent earnings which are no part of them and which indeed result only in small measure from their use as capital.

Nor do I understand how any equities can be said to exist except from an implied intent, for which there is no warrant. The notion that preferred shareholders are weaker in bargaining power may or may not be true; I know too little of the facts. Prima facie they must be taken at their word like other people, and if any tenderness is due them it should follow upon an inquiry which courts have no power to make. I agree that directors, who generally hold common shares, may be induced to starve the preferred shares in the hope of greater earnings from an increased capital, eventually taking form in greater common dividends, and though that is a somewhat remote motive, it may be real enough. But preferred shareholders, as well as common, accept the situation; the law has long advised them that their rights depend upon the judgment

of men subject to just that possible basis; the language chosen implies that their action shall be a condition upon any dividends. Why we should distort that language against the possibility of a dereliction of duty, for which, though hard to prove, the law gives redress, I do not see. Courts must not be blind, but the correction of possible injustices may come at too high a price. Words are illusive enough at best, but when all is said, they are the only means of communication we have. On the loyalty of their interpretation more in the end depends than on our power to right such wrongs as result from their inconsiderate use.

[Endorsed:] United States Circuit Court of Appeals, Second Circuit. John C. Barclay and Willoughby Co., Appellants, vs. Wabash Ry. Co. et al., Respondents. Dissenting opinion. L. Hand, C. J.

UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a stated term of the United States Circuit Court of Appeals in and for the Second Circuit, held at the court-rooms, in the Post Office building, in the city of New York, on the 14th day of January, one thousand nine hundred and twenty-nine.

Present: Hon. Martin T. Manton, Hon. Learned Hand, Hon. Augustus N. Hand, Circuit Judges.

JOHN C. BARCLAY and WILLOUGHBY COMPANY, Plaintiffs-Appellants,

v.

WABASH RAILWAY COMPANY et al., Defendants-Appellees

Appeal from the District Court of the United States for the Southern District of New York

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the decree of said District Court be, and it hereby is, reversed, with costs.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

M. T. M., L. H.

[Endorsed:] United States Circuit Court of Appeals, Second Circuit. John C. Barclay and another v. Wabash Railway Company et al. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed Jan. 14, 1929. William Parkin, Clerk.

UNITED STATES CIRCUIT COURT OF APPEALS, SOUTHERN DISTRICT OF NEW YORK

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 128, inclusive, contain a true and complete transcript of the record and proceedings had in said Court in the case of John C. Barclay and Willoughby Company, Plaintiffs-Appellants, against Wabash Railway Company et al., Defendants-Appellees, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 23rd day of January, in the year of our Lord one thousand nine hundred and twenty-nine, and of the Independence of the said United States the one hundred and fifty-third.

Wm. Parkin, Clerk. (Seal United States Circuit Court of Appeals, Second Circuit.)

[fol. 130] SUPREME COURT OF THE UNITED STATES

No. 693

ORDER ALLOWING CERTIORARI—Filed March 11, 1929

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsed:] Order granting petition for certiorari.

[fol. 131] SUPREME COURT OF THE UNITED STATES

No. 694

ORDER ALLOWING CERTIORARI—Filed March 11, 1929

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsed:] Order granting petition for certiorari.

Endorsed on cover: File No-. 34,002, 34,003. U. S. Circuit Court of Appeals, Second Circuit. Term No. 693. Wabash Railway Company, Myron S. Hall, H. W. Cohu, et al., petitioners, vs. John C. Barclay and Willoughby Company. No. 694. Shirley P. Austin, petitioner, vs. John C. Barclay and Willoughby Company. Petitions for writs of certiorari and exhibit thereto. Filed February 12, 1929. File No-. 34,002, 34,003.

FILE COPY

No. [redacted]37

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1958

[redacted]

Petitioners,

v.

[redacted]

Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit and Brief in Support Thereof

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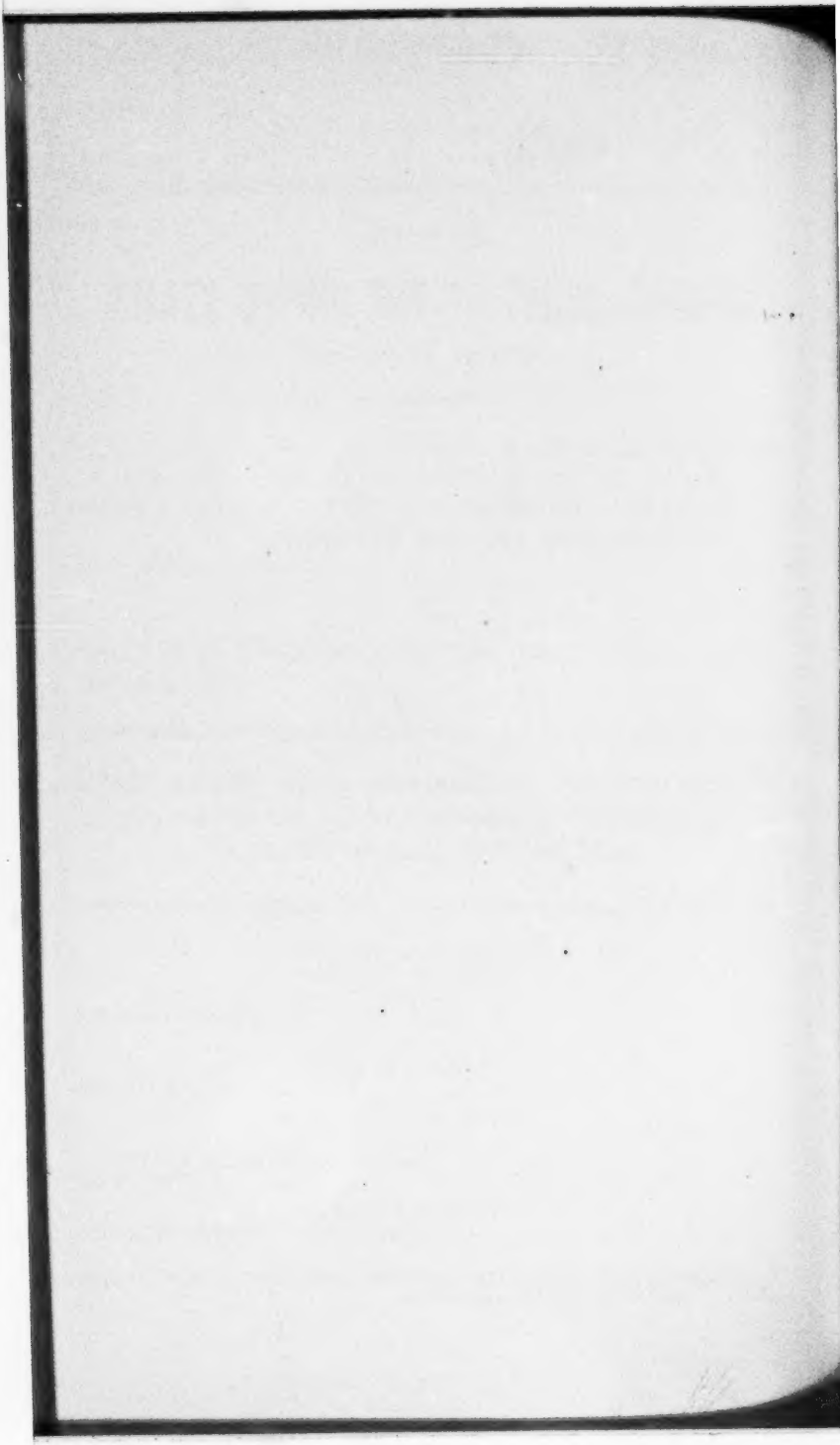

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IN THE

Supreme Court of the United States

OCTOBER TERM 1928.

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, LAMOTTE COHU, GERALD V. HOLLINS, GEORGE R. LESLIE, EARLE KRAPP and WILLIAM FRASER DICKSON,

Petitioners,

vs.

JOHN C. BARCLAY and WILLOUGHBY COMPANY,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To The Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners, Wabash Railway Company, Myron S. Hall, H. W. Cohu, LaMotte Cohu, Gerald V. Hollins, George R. Leslie, Earle Krapp and William Fraser Dickson, respectfully show:

This is a petition for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit,

to review a decision made and entered in said Circuit Court of Appeals on January 7, 1929 (Circuit Judge LEARNED HAND dissenting) by which a decree of Judge FRANCIS A. WINSLOW of the United States District Court for the Southern District of New York dismissing the bill of complaint on the merits was reversed.

On stipulation of the parties the issuance of the mandate of the Circuit Court of Appeals was ordered stayed to afford the petitioners an opportunity to apply to this Court for a writ of certiorari.

I.

Statement.

This suit was brought by John C. Barclay, as a holder of Five Per Cent Profit Sharing Preferred Stock A of Wabash Railway Company, a corporation of Indiana, to establish a dividend credit amounting to many millions of dollars in favor of the Preferred Stock A, and to enjoin payment of dividends upon its Convertible Preferred Stock B and Common Stock until such dividend credit shall be extinguished (Tr., fols. 1-33).

The defendants in the suit are the Railway Company and certain representative holders of Convertible Preferred Stock B and Common Stock (Tr., fols. 3-6).

The Willoughby Company, a corporation of Pennsylvania, and a holder of Preferred Stock A, intervened as an additional party plaintiff after the decision of Judge WINSLOW and was one of the appellants in the Circuit Court of Appeals (Tr., fol. 282).

In conformity with a charter provision, the right of the Preferred Stock A to dividends is set forth in the Preferred A Stock Certificates in the following language:

> "The holders of Five Per Cent Profit Sharing Preferred Stock A of the Company shall be entitled

to receive preferential dividends in each fiscal year up to the amount of five per cent before any dividends shall be paid upon the other stock of the Company, but such preferential dividends shall be non-cumulative" (Tr., fols. 39-47, 74-81).

II.

The Underlying Question.

The underlying question which this case presents is whether earnings accruing in years in which the full five per cent non-cumulative dividend on the Preferred Stock A was not paid, or no dividend was paid, which earnings were lawfully expended by the Directors in their sound discretion for road and equipment and used for working capital, nevertheless shall be deemed to constitute a credit to the Preferred Stock A; that is to say, the question at issue is whether a non-cumulative Preferred Stock is nevertheless cumulative as to earnings accruing in non-dividend years notwithstanding the fact that the Board of Directors in the exercise of a discretion which is not questioned, have determined that such earnings could not be disbursed in dividends but must be invested in the property.

III.

Reasons for Review.

The petitioners earnestly submit that the prevailing opinion of the Circuit Court of Appeals has decided an important question of general law in a way which is untenable and is in conflict with the weight of authority and in conflict also with at least two leading decisions of this Court, viz.: *New York, Lake Erie and Western Railroad Company* v. *Nickals*, 119 U. S. 296 (1886) and

Continental Insurance Company v. *United States*, 259 U. S. 156 (1922); in conflict with a decision of the Supreme Court of the State of Indiana, the domicile of Wabash Railway Company, viz.: *Star Publishing Company* v. *Ball*, 134 N. E. 283, and in conflict with the common interpretation which has been placed upon non-cumulative preferred stock contracts for many years.

The decision of this Court in the *Nickals* case was rendered in 1886, and hundreds of millions of dollars have been invested upon the understanding and in the belief that under that decision a non-cumulative preferred stock was *in fact* non-cumulative, and if the prevailing opinion of the Circuit Court of Appeals is to stand as the law, many holders of non-cumulative preferred stock will receive dividends in excess of the maximum prescribed by the certificate, and to which they have never deemed themselves entitled, and holders of junior stocks will find their investments impaired and in many cases entirely lost.

As indicating the great importance of this question and the widespread interest in it, the following Railroad Companies have outstanding issues of non-cumulative preferred stock which might be affected by the decision of the Circuit Court of Appeals:

Boston and Maine Railroad Company	$38,817,900 non-cumulative first Preferred Stock
Chicago, Indianapolis & Louisville Railway Company	$5,000,000 4% non-cumulative Preferred Stock
Reading Company	$28,000,000 4% non-cumulative Preferred Stock $42,000,000 4% non-cumulative Preferred Stock

Chicago & Eastern Illinois Railway Company	$22,046,100 6% Preferred Stock, non - cumulative prior to January 1, 1924
The Chicago, Milwaukee and St. Paul Railroad Company	$118,845,800 5% non-cumulative Preferred Stock
Chicago Great Western Railway Company	$47,133,002 4% Preferred Stock, non - cumulative prior to June 30, 1914
Chicago and Alton Railroad Company	$19,557,900 4% non-cumulative Preferred Stock
Colorado and Southern Railway Company	$8,500,000 4% non-cumulative first Preferred Stock $8,500,000 4% non-cumulative second Preferred Stock
Duluth, South Shore and Atlantic Railway Company	$10,000,000 6% non-cumulative Preferred Stock
Gulf, Mobile and Northern Railroad Company	$11,415,600 6% Preferred Stock, non - cumulative prior to January 1, 1920
Kansas City Southern Railway Company	$21,000,000 4% non-cumulative Preferred Stock
Missouri - Kansas - Texas Railroad Company	$45,884,622 7% Preferred Stock, non - cumulative prior to January 1, 1928

Pere Marquette Railway Company	$12,429,000 5% Preferred Stock, non - cumulative prior to January 1, 1919
Minneapolis, St. Paul and Sault Ste. Marie Railway Company	$12,603,400 7% non-cumulative Preferred Stock
Seaboard Air Line Railway Company	$25,000,000 4–2% non-cumulative Preferred Stock $2,273,100 6% non-cumulative Preferred Stock
Western Maryland Railway Company	$10,000,000 4% non-cumulative Preferred Stock
Western Pacific Railway Company	$27,500,000 6% non-cumulative Preferred Stock
Wheeling and Lake Erie Railway Company	$11,882,600 7% Preferred Stock, non - cumulative prior to November 1, 1916 $10,334,958 6% non-cumulative Preferred Stock

The foregoing is not submitted as a complete list or necessarily an accurate list. It is confined to Railroad Companies, but as this Court is aware, there are many hundreds of industrial corporations throughout the United States which have outstanding issues of non-cumulative preferred stock, and thousands of holders of railway and industrial stocks throughout the United States are vitally interested in a prompt determination of this question.

By the decisions of the Circuit Court of Appeals and the District Court, two Judges having taken one view and

two Judges having taken another view, and opinions having been filed in support of these conflicting interpretations of the decisions of this Court and of other Courts, a situation is created which if not corrected by this Court is certain to result in costly litigation throughout the United States. We beg leave to call attention to the dissenting opinion of Circuit Judge LEARNED HAND in the Circuit Court of Appeals, as well as the opinion of Judge WINSLOW in the District Court.

The American law underlying the rights of non-cumulative preferred stock is largely based upon the decision of this Court in the *Nickals* case, the doctrine of which is that the holders of non-cumulative preferred stock are not entitled *of right* to dividends payable out of profits of a particular year, unless the directors of the Company formally declare or ought to declare a dividend payable out of such profits; and if, as is manifestly the case, Judges differ as to the scope and effect of this decision to a point which threatens a widespread disturbance of property rights, it is respectfully submitted that a prompt and final settlement of the question by this Court and the consequent avoidance of conflicting decisions in the various States and in other Circuits is the high function of the writ of certiorari.

Wherefore, your petitioners, referring to the attached brief in support of the foregoing reasons for review, respectfully pray that this Honorable Court issue a writ of certiorari directed to the United States Circuit Court of Appeals for the Second Circuit, to certify and send to this Court a full and complete transcript of the record herein to the end that the said case may be reviewed and determined by this Court as provided by law, and that the decision of the Circuit Court of Appeals may be reversed, and that your petitioners may have such other

and further relief in the premises as to this Honorable Court may seem meet and just.

And your petitioners will ever pray.

WABASH RAILWAY COMPANY,

By WILLIAM H. WILLIAMS
Chairman of the Board.

MYRON S. HALL
H. W. COHU
LAMOTTE COHU
GERALD V. HOLLINS
GEORGE R. LESLIE
EARLE KRAPP
WILLIAM FRASER DICKSON

UNITED STATES OF AMERICA }
STATE OF NEW YORK } ss.:
COUNTY OF NEW YORK }

WILLIAM H. WILLIAMS, being duly sworn, deposes and says: That he is Chairman of the Board of Wabash Railway Company, one of the petitioners; that he has read the foregoing petition by him subscribed and knows the contents thereof and that the facts therein stated are true to the best of his knowledge, information and belief.

WILLIAM H. WILLIAMS

Sworn to before me this 2nd day of February, 1929.

(Signed) ALBERT SEGREN
[SEAL] Notary Public, Queens County No. 1633
Certificate filed New York County No. 717
New York County Register's No. 9589
Commission expires March 30, 1929

UNITED STATES OF AMERICA
STATE OF NEW YORK } ss.:
COUNTY OF NEW YORK

MYRON S. HALL, H. W. COHU, LAMOTTE COHU, GERALD V. HOLLINS, GEORGE R. LESLIE, EARLE KRAPP and WILLIAM FRASER DICKSON, being duly sworn, each for himself deposes and says: That he is one of the petitioners above named, that he has read the foregoing petition by him subscribed and knows the contents thereof, and that the facts therein stated are true to the best of his knowledge, information and belief.

MYRON S. HALL
H. W. COHU
LAMOTTE COHU
GERALD V. HOLLINS
GEORGE R. LESLIE
EARLE KRAPP
WILLIAM FRASER DICKSON

Subscribed and sworn to before me this 2nd day of February, 1929.

(Signed) ALBERT SEGREN
[SEAL] Notary Public, Queens County No. 1633
Certificate filed New York County No. 717
New York County Register's No. 9589
Commission expires March 30, 1929

Certificate.

We certify that we have examined the foregoing petition and that in our opinion the petition is well founded and that the case is one in which the prayer of the petition should be granted by this Court.

CHARLES E. HUGHES
F. C. NICODEMUS, JR.
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Wabash Railway Company

WINTHROP TAYLOR
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Myron S. Hall
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Gerald V. Hollins
George R. Leslie and
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ARNOLD L. DAVIS
Counsel for Petitioner
William Fraser Dickson.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1928.

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, LAMOTTE COHU, GERALD V. HOLLINS, GEORGE R. LESLIE, EARLE KRAPP and WILLIAM FRASER DICKSON,

Petitioners,

vs.

JOHN C. BARCLAY and WILLOUGHBY COMPANY,

Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Statement.

Wabash Railway Company was organized under the laws of Indiana in 1915 with three classes of capital stock:

$46,200,000 of 5% Profit Sharing Preferred Stock A
$49,970,000 of 5% Convertible Preferred Stock B
$47,290,000 of common stock.

The shares of each of the above issues is of the par value of $100. The Preferred Stock A by its terms is non-cumulative. The Preferred Stock B by its terms is convertible after August 1, 1918, into Preferred Stock A and common stock, one share of Preferred Stock B being exchangeable for 50% of its par value in Preferred Stock A

and 50% of its par value in common stock. The Preferred Stock A is preferential in dividends as against both the Preferred Stock B and the common stock and the Preferred Stock B is preferential in dividends as against the common stock, each of these preferred issues being entitled to 5% dividends in each year in preference and priority to the junior stock or stocks (Tr., fols. 34-71). After payment or setting apart in any one fiscal year of five per cent. dividends on the Preferred Stock A, and the Preferred Stock B and on the Common Stock, the Preferred Stock A and Common Stock participate equally in any further dividend distributions (Tr., fols. 76-78).

In event of liquidation the Preferred Stock A is entitled to be paid its full par value plus any *declared* and unpaid dividends, before any payment is made to the Preferred Stock B or common stock; the Preferred Stock B is entitled to be paid its full par value plus any *declared* and unpaid dividends before any payment is made to the common stock; but after payment in full of these amounts to the Preferred A and Preferred B stocks all three classes share equally in the distribution of any remaining assets (Tr., fols. 34-71, 73-82).

The Preferred Stock A is redeemable after December 1, 1920, at the price of 110% of its par value (Tr., fol. 41).

All three classes of stock have equal voting rights (Tr., fol. 80).

The foregoing indicates the salient features of the financial structure of the Railway Company.

In every fiscal year from the date of the organization of the Railway Company to the year 1926, with one or two possible exceptions, there were earnings which the Board of Directors might have applied to the payment of dividends upon the Preferred Stock A without impairing the Railway Company's capital. In certain of these

years, however, the Board declared no dividend on the Preferred Stock A or declared a dividend at a rate lower than 5% (Tr., fols. 15-17, 93, 94, 191).

It was the judgment of the Board of Directors that these earnings ought not to be used for the payment of dividends, but should be applied to the development and improvement of the property which had only recently emerged from receivership (Tr., fol. 94).

That the Board exercised its discretion soundly and fairly is conceded.

This case was heard in the District Court on Bill and Answer, the motion for decree being made upon the pleadings. The allegations of the Answer stand admitted. It was alleged in paragraph Eighth of the Answer and admitted by the motion for decree as follows:

> "The Railway Company admits the allegations contained in paragraph Eighth of the Complaint respecting the payment and non-payment of dividends between the years 1915 and 1926, but it denies that there were large net earnings available for dividends on its Preferred Stock 'A' in the period mentioned in said paragraph and denies that its earnings in any part or parts of said period justified the payment of any dividends which were not actually paid, and, although admitting balances of net earnings in certain non-dividend periods over expenses and prior charges, the Railway Company denies that any part of such balances could, consistently with its lawful obligations to its stockholders, or with its duties to the public in safe and efficient maintenance of property and service, or with sound discretion and the duty of its directors, have been distributed to stockholders, and avers that its entire surplus earnings of all periods since the incorporation of the Railway Company not actually distributed to stockholders and not

reserved for working capital or necessary corporate requirements has been actually appropriated to and is now represented by fixed and permanent improvements and additions to the property and equipment of the Railway Company to enable it adequately to discharge its public duties and protect its property, and that no part of such alleged surplus is represented by any cash or liquid fund or by any accumulation of cash assets available for dividends" (Tr., fols. 93-95).

It is thus alleged in the Answer, and admitted by the respondents, that no part of these earnings could consistently with the lawful obligations of the Railway Company to its stockholders and with its duties to the public in safe and efficient maintenance of property and service or with the sound discretion and duty of its directors, have been distributed to stockholders and that its entire surplus earnings of all periods since its incorporation not actually distributed to the stockholders and reserved for working capital or necessary corporate requirements has been actually appropriated to and is now represented by *fixed and permanent improvements and additions to the property and equipment of the Railway Company to enable it adequately to discharge its public duties and protect its property and that no part of its alleged surplus is represented by any cash or liquid fund or by any accumulation of cash assets available for dividends.*

I.

ARGUMENT.

The discretion of the Board of Directors in the appropriation of earnings for capital purposes is unfettered by the conditions sought to be imposed by the Circuit Court of Appeals.

In pursuing the policy of investing surplus earnings in equipment and plant, the Directors relied upon the decision of this Court in *New York, Lake Erie & Western Railway Company* v. *Nickals*, 119 U. S. 296 (1886). In this case holders of non-cumulative preferred stock sought to compel the Directors to appropriate earnings to the payment of dividends, although in the judgment of the Directors the earnings should be invested in property. This Court sustained the Directors. The following brief quotation from the opinion of Mr. Justice HARLAN discloses the full scope and effect of this Court's decision:

> "A different view would lead to results which sound policy would seem to forbid, and which, therefore, it is not to be supposed were contemplated by the parties. For, if preferred stockholders become entitled to dividends upon a mere ascertainment of profits for a particular year, the duty of the company to maintain its track and cars in such condition as to accommodate the public and provide for the safe transportation of passengers and freight would be subordinate to their right to payment out of the funds remaining on hand after meeting current expenses and fixed charges. Indeed, there is some ground to contend that, according to appellee's interpretation of the charter, the directors were not at liberty, in any year when the current receipts were in excess of operating expenses, to pay even interest on funded debt, or

> rentals of leased lines, before paying a dividend on preferred stock. We are of opinion that while the agreement of 1877 and the Articles of Association sustained the claim of preferred stockholders to a 6% dividend in advance of common stockholders, the former are not entitled, of right, to dividends, payable out of the net profits accruing in any particular year, unless the directors of the company formally declare, or ought to declare a dividend payable out of such profits; and whether a dividend should be declared in any year is a matter belonging in the first instance to the directors to determine, with reference to the condition of the company's property and affairs as a whole. As the evidence shows that the profits for the year ending September 30, 1880 were applied to objects that were legitimate and proper, and as the condition of the company was not such as to make the declaration of a dividend a duty upon the part of the directors, we perceive no ground upon which the claim of the appellees can be sustained."

For nearly fifty years it has been the common understanding that in the absence of a statute or contract stipulation to the contrary the discretion of corporate directors in the payment or non-payment of non-cumulative dividends as thus established by this Court is free and unfettered so long as exercised soundly and in good faith; but, under the decision of the Circuit Court of Appeals in the present case, this discretion is completely undermined and annulled; henceforth, if the decision is permitted to stand the discretion of the directors must be exercised subject to at least two destructive conditions:

First: That earnings invested in plant and equipment which might have been used for dividends no longer constitute corporate capital but constitute a separate fund which must be set apart to the credit of the non-cumulative preferred stock.

Second: That no dividends may be declared on junior stocks *even out of current earnings* and in years in which the *full* dividend is paid upon the senior stock or stocks, until the dividend credit of the senior stock is fully satisfied and discharged by the payment of all dividends which the Directors might have declared upon the senior stock in past years if they had not exercised their discretion to invest such earnings in plant and equipment.

The Railway Company earnestly contends that the imposition of such conditions is fundamentally irreconcilable with the underlying principles of the *Nickals* case.

Moreover, the Railway Company confidently submits that the first condition is in conflict with the decision of this Court in the case of *Continental Insurance Company* v. *United States*, 259 U. S. 156 (1922) and that the second condition cannot be reconciled with the decision of the Supreme Court of the State of Indiana in the case of *Star Publishing Company* v. *Ball*, 134 N. E. 283.

The first of these cases arose out of the dissolution of the Reading Company. The controversy there related to the rights of the common stock and the preferred stock in the distribution of capital assets. In that case dividends had been paid for a number of years upon non-cumulative preferred stock, but the Directors of the Company, in the exercise of their sound discretion, had utilized earnings which might have been applied to dividends upon the common stock in building up the property. The common stockholders contended that upon dissolution, the earnings which might have been applied to dividends on the common stock up to the amount of distributions on the preferred stock should be treated in equity as a credit to the common stock. This Court rejected this

contention. The following is from the opinion of Chief Justice Taft:

> "The proper interpretation of the agreement is that, after the declaration of dividends for any current year, the undivided earnings are to be regarded as *capital assets* (our italics) and to be distributed on liquidation, unless the Board of Directors has meantime applied them as dividends. If the argument of appellants were carried to its logical result, all the net earnings of the Reading Company in twenty-five years, no matter how invested or applied to increasing the earning capital, must in liquidation be treated as undistributed profits to go entirely to the common stock without any action of the Board of Directors. This is impossible."

Unless this decision of this Court is to be overruled, it is respectfully submitted that all of the earnings of Wabash Railway Company which the Directors, in the exercise of discretion fully sanctioned by the *Nickals* case invested in road and equipment, must be treated as "capital assets" and cannot be treated as a separate fund equitably owned by the holders of the Preferred Stock A.

The second condition imposed upon the directorial discretion by the decision of the Circuit Court of Appeals places a perpetual restraint upon the payment of dividends upon junior stocks even out of current earnings, unless the amounts already vested in the property and held for working capital are first applied to the satisfaction of the dividend credits of the Preferred Stock A. Even if the Circuit Court of Appeals is right in setting up a separate trust fund for the benefit of Preferred Stock A, all that could possibly be claimed is that such fund ought not to be utilized for dividends on junior stock; there is clearly no logical reason, so long as the trust fund

remains unimpaired, to enjoin the payment of dividends out of current earnings and other resources upon the junior stocks in years in which the full Preferred A dividend is paid. This is not a case where the amounts previously invested in property of the Railway Company and held for working capital are withdrawn and distributed in whole or in part. This is a case where these investments are still held intact and not distributed. *Thus payment of a dividend upon the Preferred Stock B for 1928 already declared out of current earnings is enjoined, although a full 5% dividend for 1928 has been paid upon the Preferred Stock A.*

Apart from the fact that an injunction against the payment of such dividends cannot be reconciled with the *Nickals* case, it is in direct conflict with the decision of the Supreme Court of Indiana in the case last above cited.

The Star Publishing Company was an industrial corporation organized under the laws of Indiana, having outstanding non-cumulative preferred stock and common stock. From 1908 to the time of the institution of the suit, the Publishing Company was prosperous and it appears from the opinion of the Supreme Court of Indiana that from 1911 to 1918 the company could have paid on the first days of March, June, September and December, dividends at the rate of 5% per annum on its preferred stock without depleting its cash assets, impairing its solvency or the rights of its shareholders. During this period the Board of Directors withheld payment of dividends upon the preferred stock and the Supreme Court held that as to at least a part of this period, there had been a gross breach of discretion. It accordingly decreed the payment of dividends upon the preferred stock to the extent of $39,050, although the amount of unpaid dividends on the preferred stock was actually $62,125.

Notwithstanding the fact that $23,075 of preferred dividends remained unpaid, the Court approved the payment of a dividend on the common stock. It is submitted that the foregoing decision under which a dividend was decreed to be paid upon common stock, although dividends on the non-cumulative preferred stock were unpaid during a long period in which they were regularly earned, definitely commits the Supreme Court of Indiana—the State of the domicile of Wabash Railway Company—to the position taken by Circuit Judge LEARNED HAND in his dissenting opinion.

A review of the authorities relied upon by the respondents cannot be made within the limits of this brief. They are reviewed in the opinion of the Circuit Court of Appeals and the dissenting opinion of Circuit Judge LEARNED HAND. All of them will be found to be distinguishable and inapplicable. The cases of *Wood* v. *Lary*, 47 Hun 550 and *Burk* v. *Ottawa Gas & Electric Co.*, 123 Pac. 857, were based upon contracts under which the Board of Directors had no discretion. The case of *Day* v. *U. S. Cast Iron Pipe & Foundry Company*, 126 Atl. 302 and other New Jersey cases arose under a New Jersey statute which also abridged the ordinary directorial discretion. The case of *Collins* v. *Portland Electric Power Co.*, 12 Fed. Rep. (2d Series) 671, is inconclusive; it did not touch the fundamental question decided in the present case by the Circuit Court of Appeals.

That the Circuit Court of Appeals was influenced in reaching the conclusion which it did reach by the argument that unless their discretion is conditioned and restrained Directors may be tempted to build up a property in the interest of junior stocks at the expense of non-cumulative Preferred Stocks is manifest. This plainly is merely speculative. All the stockholders in this case, preferred and common, have equal voting rights and there is no cumulative voting under the laws of Indiana

and preferred shares, which at the outset outnumbered the common shares two to one, are still in the majority according to the record (Tr., fols. 7-9). *Non constat* the Directors have as much Preferred Stock as Common Stock or even more. Such speculations should not be permitted to upset contract rights long vested.

A complete analysis of the Preferred A contract would unduly extend this brief. It is, however, to be noted:

(a) That the Preferred A dividend is "preferential" but not guaranteed or made a charge upon earnings.

(b) That each fiscal year is a separate accounting period and that the preference relates to each accounting period and is not general as in the case of cumulative stock.

(c) That the preference is limited to "dividends" implying the exercise of the ordinary directorial discretion in the creation of a definite legal right.

(d) That the "dividends" are to be "non-cumulative," meaning, as Black says, that "its preference for any given year is extinguished by failure to earn or pay its dividend in that year."

(e) That an additional dividend may be paid upon the Preferred A after paying or setting apart the full dividend in the B stock and 5% on the common, but such additional dividend, like the preferential dividend is dependent upon (1) a declaration by the Board exercising its discretion which (2) must be made "in that year."

(f) That upon liquidation, holders of Preferred Stock A are to be paid the full par value of their shares "and all dividends thereon *declared* and unpaid"—the contract again invoking instead of fettering the ordinary discretion of the directors.

(g) That in like manner the Preferred B and Common Stock are to receive in liquidation the full amount of any "declared and unpaid" dividends.

(h) That in event of a conversion of B Stock into Preferred A and Common there is to be an adjustment "of *declared* and unpaid dividends," but if the present contention of the A stockholders is sound, why not an adjustment of *earned* and *undeclared* dividends? Clearly such a contingency was never contemplated by the author of the Preferred A contract.

(i) That the Preferred Stock A is redeemable as a matter of contract right at 110%—a right clearly inconsistent with the conception of a credit in respect to earnings as to which no dividend is declared.

Moreover, a large amount of Preferred Stock A has been issued over a period of years subsequent to August 1, 1918, upon conversions of Preferred Stock B. Much of the new stock was issued after the alleged dividend credit accrued and clearly such new Preferred A Stock is not entitled to the credit in any event, but much of this new stock has become commingled with the original stock and cannot be identified so that the decision of the Circuit Court of Appeals, even if sound, which we earnestly submit is not the case, is definitely unworkable.

There is further complication. For many years the three stocks of Wabash Railway Company have been listed on the New York Stock Exchange. All shares of Preferred Stock A have been upon a parity and have been quoted at one figure. Under the decision of the Circuit Court of Appeals, it would become necessary to treat shares differently, the difference to be based upon the interest which a particular share has in the alleged dividend credit. Certain shares would be quoted at one price, other shares at another price, and still other shares, perhaps the largest number of all, could not be quoted accurately in relation to the alleged dividend credit, because, as already noted, such stock has lost its identity

and could not be traced to stock issued at a particular time and identified in any definite way with the dividend credit accorded to them by the decision of the Circuit Court of Appeals.

A table showing the period of years over which the Preferred Stock A was issued appears in the record (Tr., fol. 198).

It is submitted that this great question of general law has been erroneously decided by the Circuit Court of Appeals and that the decision of the Circuit Court of Appeals should be reviewed by writ of certiorari and reversed.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1928

SHIRLEY P. AUSTIN

Petitioner

v.

JOHN C. BARCLAY and WILLOUGHBY COMPANY

Respondents

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit and Brief in Support Thereof

√CHARLES E. HUGHES
Counsel for Petitioner
Shirley P. Austin

APPEAL PRINTING CO., 80 THAMES ST., NEW YORK CITY

IN THE

Supreme Court of the United States

OCTOBER TERM—1928.

SHIRLEY P. AUSTIN,

Petitioner,

v.

JOHN C. BARCLAY and WILLOUGHBY COMPANY,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Shirley P. Austin, respectfully shows:

This is a petition for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit to review a decision made and entered in said Circuit Court of Appeals on January 7, 1929, reversing a decree of the District Court for the Southern District of New York in a cause in which John C. Barclay and the Willoughby Company are plaintiffs, and Wabash Railway Company and certain individuals, including your petitioner, are defendants (Tr. fols. 8-12).

The purpose of the suit is to assert an equitable credit or lien in favor of holders of Preferred Stock A of Wabash Railway Company in respect of past earnings of said Railway Company and to enjoin payment of dividends upon the Preferred Stock B and Common Stock of the Company until such credit or lien is discharged (Tr. fols. 27-32).

Your petitioner, a general partner in the firm of C. D. Halsey & Company, members of the New York Stock Exchange and registered owners of 15,505 shares of the Common Stock of said Railway Company has been joined as a party to the suit to represent the holders of Common Stock which, as alleged in the Bill of Complaint, are numerous and widely scattered (Tr. fols. 5, 11, 12). As of the latest date shown by the record, the outstanding Common Stock amounts to $66,697,700, consisting of 666,977 shares of the par value of $100 each. Your petitioner is advised that said shares of Common Stock are held by more than 1,000 individuals, firms and corporations (Tr. fols. 9-11).

By the decision of the Circuit Court of Appeals earnings of the Railway Company accumulated during the period from 1916 to 1926 inclusive and amounting to $16,127,250 now invested in road and equipment and held for working capital, are "marked, in a sense, in favor of such (Preferred A) stockholders" and "cannot be used for the payment of dividends on any stock junior to Preferred A until that credit has been satisfied" and in the meantime dividends upon the junior stocks, including the $66,697,700 par value of Common Stock represented by the petitioner, are to be enjoined (Opinion of Circuit Judge MANTON, pp. 6 and 19; Tr. fols. 18, 198, 205).

Reasons for Review.

Wabash Railway Company and certain individuals are submitting to this Court a petition for a writ of certiorari to review said decision and your petitioner respectfully asks leave to unite in said petition and to urge that the writ be granted for the reasons and upon the authorities therein set forth and for the further reason that said decision is in conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in the case of *Missouri Pacific Railroad Company* v. *Texas and Pacific Railway Company and others,* 282 Fed. Rep. 61.

In addition, your petitioner respectfully asks that this Court consider the following facts which your petitioner submits show the great importance of this cause as affecting alike the interest of the public and the property rights of the common stockholders of Wabash Railway Company and also as affecting the stockholders of many other incorporated companies, both railroad and industrial, having issues of non-cumulative preferred stock outstanding.

(a) **The Public Interest:** An examination of Poor's Manual of Railroads, which contains historical information and detailed data respecting Railway Companies, will disclose that most of the great rail transportation systems of the Country, particularly those which have passed through receivership and reorganization, have financial structures based upon one or more issues of preferred stock which are either wholly non-cumulative or non-cumulative for a stated period of years after organization or reorganization. The underlying purpose of such a financial structure was to give to the Boards of Directors of the companies discretionary power and authority freely to use the corporate earnings in building up these

properties to the standards necessary to enable them to discharge their public obligations—and it was a necessary and vital feature of a financial structure thus conceived that if in any year the Board of Directors found it necessary to apply to capital purposes income which otherwise might have been used for dividends, the non-cumulative preferred stockholder was not entitled to any dividend distribution for that year but was to be compensated for his loss of income by the increased earning power of the corporation and permanency of income in future years. That such was the nature of the non-cumulative Preferred Stock contract is, your petitioner submits, clearly shown by the opinion of Mr. Justice HARLAN in the *Nickals* case, decided at a time when many railroad companies, which are today strong and prosperous, were in process of reorganization. Thus the non-cumulative Preferred Stock certificate of St. Louis Southwestern Railway Company, a reorganized Company created five years after the decision of this Court in the *Nickals* case, provides:

> "The holders of the Preferred Stock are entitled in each year to receive dividends at the rate of five per cent. per annum payable out of the net profits of the Company before any dividends shall be declared or paid on the Common Stock for such year but if in any year dividends amounting to five per cent. shall not be declared payable on the Preferred Stock the holders shall not thereafter receive any further dividends for said year the dividends on the Preferred Stock not being cumulative."

Your petitioner respectfully submits that the decision of the Circuit Court of Appeals, if allowed to stand unreversed, will for reasons hereinafter developed make it necessary for many transportation Companies of the

Country to abandon or restrict the conservative policy of capitalizing earnings when necessary for betterments or improvements and will tend to restrict future financing to income bonds and cumulative Preferred Stock to the great detriment of the public which is vitally interested in sound and conservative financing and efficient transportation service.

(b) **The Disturbance of Vested Property Rights:** Wabash Railway Company was reorganized during the European War with no open mortgage and no currency available for betterments and improvements other than its earnings. For this reason, both of its two issues of Preferred Stock, the Preferred Stock A and the Preferred Stock B, were made non-cumulative. During the period between 1915 and 1926, there were earnings aggregating $37,346,569, all of which, excepting $4,895,361 distributed as dividends upon the Preferred Stock A, was utilized in building up the property to its present standard of efficiency and earning power (Tr. fols. 39-48; 93-95; 198). This policy was pursued while the voting control of the Company rested in the holders of its two issues of non-cumulative Preferred Stock and was not pursued at the expense of the Preferred Stock A for the reason that the larger part of the invested surplus at the end of the year 1926 represented earnings, which, if distributed, would have been distributed to the holders of the Preferred Stock B and Common Stock (Tr. fol. 198).

Your petitioner is informed that at no time prior to the institution of this litigation, was there any claim or suggestion that the Board of Directors of the Railway Company, instead of building up its property for the benefit of all of the stockholders of the Company, were in fact building up a huge dividend credit for the benefit of the

Preferred Stock A. Your petitioner respectfully submits that the creation of such a dividend credit by judicial decree and the "marking" of invested surplus to satisfy such a credit will emasculate the financial structure of the Railway Company, impair the investment of the Common stockholders which your petitioner represents, and cause a widespread disturbance of property rights which have long vested upon the faith of this Court's decision in the *Nickals* case. The far-reaching character of the decision of the Circuit Court of Appeals in its relation to innumerable railroad companies and industrial companies throughout the United States is obvious, but putting aside the effect of the decision upon other companies and the stockholders of other companies and considering only the situation of Wabash Railway Company and the property rights of the holders of the $66,697,700 of its common stock represented by the petitioner, it is submitted that the questions presented are of sufficient importance to justify a review by this Court, particularly in view of the even division of opinion among the Judges of the Circuit Court of Appeals and the District Court and the certainty that the decision of the Circuit Court of Appeals cannot be carried into effect without difficult and disastrous litigation to determine the extent of the dividend credit allowed to the Preferred A stockholders and to determine the extent which particular Preferred A stockholders are entitled to participate in it.

To illustrate:

(1) During the years 1916, 1917 and 1918, there were earnings aggregating $15,486,352 out of which Preferred A dividends were declared and paid in the amount of $2,310,000, leaving a balance of $13,176,352. Against this balance, dividend credits are claimed in the amount of

$5,283,225, so that if the accounts of the Railway Company were recast to mark a part of this surplus to the credit of Preferred Stock A, $5,283,225 thereof would be so marked, leaving a balance of $7,893,127 of surplus either free or marked for the junior issue. But in the years 1919 and 1920, there were operating deficits aggregating $9,918,778 —an amount sufficient entirely to wipe out either the marked surplus or the free surplus and impinge upon the other, and the question at once arises whether such deficits are chargeable wholly against the marked surplus or wholly against the free surplus or chargeable pro rata against the marked surplus and the free surplus, or whether, once a dividend credit has accrued, it survives all future deficits as a continuing charge against the future prosperity of the Company. The petitioner respectfully submits that these questions which arise upon the face of the record are questions which a Board of Directors could not be asked to determine without the protection of a decree of Court.*

(2) It appears from the record that in each of the years 1916 to 1925, inclusive, substantial amounts of Preferred Stock A were issued in conversion of Preferred Stock B, the total outstanding shares of Preferred Stock A increasing from 462,000 in 1917 to 693,058½ in 1925 (Tr. fol. 198). Assuming that the issue of these new Preferred A shares was distributed over a twelve months period in each year in which a dividend credit accrued, there are a minimum of 84 dividend credits, each differing in amount, applicable to the stock outstanding in 1925 which would give 84 different values to an issue of stock, the shares of which are listed on the New York Stock Exchange and have always been bought and sold upon the assumption that all

* See statistical data, Tr. fols. 191-192; 198.

shares had the same value and this situation will be further complicated by the new Preferred Stock issued in conversion subsequent to 1925. Your petitioner earnestly submits that even if it were possible to identify the present outstanding shares with stock issued at a particular date, which in many cases it will be impossible to do, a situation is created which, if the decision of the Circuit Court of Appeals is permitted to stand, is certain to result in long, costly and disastrous litigation to determine the interest of particular Preferred A Stock certificates in the marked surplus.

When these inherent difficulties are considered it is apparent that if the decision of the Circuit Court of Appeals is permitted to stand, companies having non-cumulative preferred stocks outstanding will be obliged in practice to treat them as in effect cumulative and pay dividends thereon when sound judgment and discretion forbids the payment of dividends and will also prevent the use for future capital purpose of unissued amounts of non-cumulative preferred stock which, if put in circulation, would become commingled with other stock of the same issue having dividend credits, giving it a different value and a different relation to corporate surplus.

(c) **Accounting Problems:** Since July 1, 1914, the rail carriers of the United States have been required to keep their accounts in accordance with the uniform classification prescribed by the Interstate Commerce Commission in pursuance of Section 20 of the Act to Regulate Commerce. No rule has ever been prescribed for "marking" corporate surplus as subject to dividend credits in favor of non-cumulative preferred stock, and an analysis of Section 20 would indicate that a situation requiring such an account was not contemplated by Congress. Your pe-

titioner believes and avers that the difficulties of maintaining such an account with constant fluctuations of surplus and constant changes in the volume of outstanding Preferred shares are insuperable, but if the decision of the Circuit Court of Appeals is permitted to stand, the duty will apparently devolve upon the Interstate Commerce Commission to deal with this problem and prescribe the rules whereby the balance sheets of carriers subject to the Interstate Commerce Act will show the corporate surplus marked for dividend credits and truly reflect the interest of the preferred stockholders therein.

(d) **The Destruction of Stock Exchange Markets for Non-cumulative Preferred Stocks:** Your petitioner's firm is represented upon the New York Stock Exchange and upon the New York Curb Exchange which have listed for trading the non-cumulative preferred stocks of many railroad companies and industrial companies, the amounts of which aggregate many hundreds of millions of dollars. Stockholders of these companies will suffer and the Exchanges will suffer if it becomes necessary to discontinue trading in securities of this class. Unlike mortgage bonds which bear serial numbers and which may be identified as to date of issue or any other individual characteristic, shares of stock are represented by certificates which have no permanent identity and when transferred to new owners are cancelled, and the shares represented thereby are divided and united with other shares and new certificates therefor are issued which cannot be traced to or identified with particular shares surrendered for transfer. By this process, which is a daily process in all active transfer offices, shares of stock lose all identity and for purposes of sale are treated and must continue to be treated as an insoluble mass. If, therefore, the decision of the Circuit

Court of Appeals is permitted to stand, it is difficult to understand how the Exchanges can continue to carry upon their trading lists stocks represented by shares which, while apparently equal in all respects, are affected by latent or concealed equities, the extent of which cannot be determined by an analysis of the company's balance sheet and can only be determined if at all by ascertaining the year and the month of the year in which the particular shares are issued.

Your petitioner respectfully submits that the foregoing clearly shows that underlying the decision of the Circuit Court of Appeals are important and far reaching questions of general law which have been erroneously decided by that Honorable Court and which this Court ought to review by writ of certiorari.

Wherefore your petitioner, referring to the attached brief in support of its reasons for review, respectfully prays that this Court issue a writ of certiorari directed to the United States Circuit Court of Appeals for the Second Circuit to certify and send to this Court a full and complete transcript of the record herein, to the end that the said case may be reviewed and determined by this Court as provided by law, and that the decision of said Circuit Court of Appeals may be reversed, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

And your petitioner will ever pray.

SHIRLEY P. AUSTIN.

UNITED STATES OF AMERICA
STATE OF PENNSYLVANIA
COUNTY OF ALLEGHENY

SHIRLEY P. AUSTIN, being duly sworn, deposes and says that he is the petitioner above named; that he has read the foregoing petition by him subscribed and knows the contents thereof and that the facts therein stated are true to the best of his knowledge, information and belief.

SHIRLEY P. AUSTIN.

Subscribed and sworn to before me this 9 day of February, 1929.

(Signed) L. HERMAN,
Notary Public.
[NOTARIAL SEAL]

My Commission expires March 7, 1931.

Certificate.

I certify that I have examined the foregoing petition and that in my opinion the petition is well founded and that the case is one in which the prayer of the petition should be granted by this Court.

CHARLES E. HUGHES,
Counsel for Petitioner Shirley P. Austin.

Supreme Court of the United States

OCTOBER TERM—1928.

SHIRLEY P. AUSTIN,

Petitioner,

v.

JOHN C. BARCLAY and WILLOUGHBY COMPANY,

Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

In support of the foregoing petition for a writ of certiorari, the petitioner asks leave to adopt the brief filed herein on behalf of Wabash Railway Company and other individual defendants.

Attention is, however, directed to the case of *Missouri Pacific Railroad Company and others* v. *Texas and Pacific Railway Company and others*, 282 Fed. Rep. 61.

In this case, the Circuit Court of Appeals for the Fifth Circuit, following the decision of this Court in the *Nickals* case, held that income bondholders were not entitled in later years to recover out of accumulated surplus interest for years in which the Board of Directors determined that the current earnings ought to be invested in road and equipment. If an income bondholder must lose his claim to interest when earnings which might have been applied thereto are invested in road and equipment, it is difficult to reconcile such conclusion with the decision of the Cir-

cuit Court of Appeals for the Second Circuit, which gives a superior position to a non-cumulative Preferred Stock.

It is submitted that the decision of the Circuit Court of Appeals for the Second Circuit in the present case is in conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in the case above cited and that for this reason, in addition to all of the reasons urged in the annexed petition, the decision of the Circuit Court of Appeals for the Second Circuit should be reviewed by writ of certiorari and reversed.

Respectfully submitted,

CHARLES E. HUGHES,
Counsel for Petitioner Shirley P. Austin.

FILED
OCT 5 1929
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM, 1928.

No. 37

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, *et al.*,
Petitioners,

vs.

JOHN C. BARCLAY AND WILLOUGHBY COMPANY.

No. 38

SHIRLEY P. AUSTIN,
Petitioner,

vs.

JOHN C. BARCLAY AND WILLOUGHBY COMPANY.

BRIEF ON BEHALF OF PETITIONERS.

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Supreme Court of the United States,

October Term, 1928.

No. 693.

WABASH RAILWAY COMPANY, MYRON S. HALE, H. W. COHU, *et al.*,

Petitioners,

vs.

JOHN C. BARCLAY AND WILLOUGHBY COMPANY.

No. 694.

SHIRLEY P. AUSTIN,

Petitioner,

vs.

JOHN C. BARCLAY AND WILLOUGHBY COMPANY.

BRIEF ON BEHALF OF PETITIONERS.

STATEMENT.

I.

Preliminary.

(a) Jurisdiction of this Court.

This case is presented to this Court upon writs of certiorari to the United States Circuit Court of Appeals for the Second Circuit to review a decree of that Court

filed January 14, 1929, reversing a decree of the District Court of the United States for the Southern District of New York filed January 16, 1928, dismissing the bill of complaint upon the merits (Tr., pp. 47; 83; 86).

(b) Jurisdiction of the District Court.

The suit was brought in the United States District Court for the Southern District of New York by John C. Barclay, a citizen and resident of the State of New Jersey against Wabash Railway Company, a corporation of the State of Indiana and certain individuals, all of whom are citizens and residents of States other than the State of New Jersey and the bill of complaint alleges that the suit is one of a civil nature in equity and that the matter in controversy, exclusive of interest and costs, exceeds $3,000 (Tr., pp. 1, 2).

(c) Nature and purpose of suit.

The plaintiff, John C. Barclay, a holder of Five Per Cent. Profit Sharing Preferred Stock A of Wabash Railway Company, brought this suit to establish a dividend credit amounting to many millions of dollars in favor of the Preferred Stock A and to enjoin payment of dividends upon the Convertible Preferred Stock B and Common Stock of the Railway Company until such dividend credit shall be extinguished (Tr., pp. 1; 5; 6; 7; 8). The bill of complaint alleges that the holders of the Preferred Stock B and Common Stock are numerous and widely scattered and that Myron S. Hall, H. W. Cohu and LaMotte T. Cohu, co-partners owning and holding 2,197 shares of the Preferred Stock B have been made parties defendant as representatives of the holders of Preferred Stock B and that Gerald V. Hollins, Shirley P. Austin and George R. Leslie, co-partners owning and holding

15,505 shares of Common Stock, and Earl Krapp, owner and holder of 1,500 shares of Common Stock have been made parties defendant as representatives of the holders of Common Stock (Tr., p. 3). Prior to the hearing in the District Court, William Fraser Dickson, a resident of the State of Pennsylvania and the holder and owner of Common Stock, intervened and was made a party defendant (Tr., p. 32). After entry of the decree in the District Court, the Willoughby Company, a corporation of the State of Pennsylvania and a holder of Preferred Stock A, intervened and was made a party plaintiff—such intervention being in subordination to and in recognition of the propriety of the main proceeding and without prejudice to any proceedings theretofore had in the cause (Tr., p. 59).

(d) Proceedings in the District Court.

After answers to the bill of complaint had been filed by the Railway Company and by all other defendants excepting the intervener Dickson, the plaintiff applied to the District Court (Judge Francis A. Winslow) for a temporary injunction to restrain payment of dividends upon the Preferred Stock B and Common Stock of the Railway Company until preferential dividends at the rate of 5% in each year upon the Preferred Stock A from the date of the organization of the Railway Company to and including the year 1926 "to the extent that the Railway Company has had net earnings available for the payment of such dividends and to the extent that such dividends remain unpaid" shall have been paid to the holders of said Preferred Stock A (Tr., p. 39).

At the same time, the defendant Dickson applied for an order dismissing the bill of complaint for want of equity (Tr., p. 46).

After full hearing upon these motions, the suggestion was made by the District Court and was accepted by all counsel in open Court that the defendant Dickson withdraw his motion to dismiss the bill of complaint and file an answer thereto and that the plaintiff's motion for an injunction be treated as a motion for a final decree on the pleadings; and an order making this arrangement effective was entered by the District Court on December 28, 1927, upon stipulation (Tr., p. 47).

On January 12, 1928, Judge Winslow filed an opinion directing the dismissal of the bill of complaint on the merits and on the same date a decree to this effect was entered (Tr., p. 48).

(e) Proceedings in the Circuit Court of Appeals.

The original plaintiff Barclay, and the added plaintiff, Willoughby Company, appealed to the Circuit Court of Appeals from the decree of the District Court and on January 14, 1929, the Circuit Court of Appeals—Circuit Judge Learned Hand dissenting—ordered that the decree be reversed. The prevailing opinion of the Circuit Court of Appeals was written by Circuit Judge Manton and was concurred in by Circuit Judge Augustus N. Hand (Tr., pp. 65-83).

II.

The Underlying Facts.

Wabash Railway Company was organized October 22, 1915, under the laws of the State of Indiana with three classes of capital stock:

$46,200,000 of 5% Profit Sharing Preferred Stock A.

$49,970,000 of 5% Convertible Preferred Stock B.
$47,290,000 of Common Stock.
(Tr., pp. 8; 9; 10).

The shares of each of the above issues are of the par value of $100 (Tr., p. 9).

The Preferred Stock A by its terms is non-cumulative (Tr., p. 10).

The Preferred Stock B also by its terms non-cumulative is convertible after August 1, 1918 into Preferred Stock A and Common Stock, one share of Preferred Stock B being exchangeable for 50% of its par value in Preferred Stock A and 50% of its par value in Common Stock (Tr., p. 11).

The Preferred Stock A is preferential in dividends as against both the Preferred Stock B and the Common Stock and the Preferred Stock B is preferential in dividends as against the Common Stock, each of these Preferred issues being entitled to receive 5% dividends in each year in preference and priority to the junior stock or stocks (Tr., p. 10). After payment or setting apart in any one fiscal year of 5% dividends on the Preferred Stock A and the Preferred Stock B and on the Common Stock, the Preferred Stock A and Common Stock participate equally in any further dividend distributions (Tr., p. 10). In the event of liquidation, the Preferred Stock A is entitled to be paid its full par value, and all dividends thereon *declared* and unpaid, before any payment is made to the Preferred Stock B or Common Stock; the Preferred Stock B is entitled to be paid its full par value, and all dividends thereon *declared* or unpaid, before any payment is made to the Common Stock; but after the payment in full of these amounts to the Preferred A and to the Preferred B stocks, all three classes

share equally in the distribution of any remaining assets (Tr., p. 10). The Preferred Stock A is redeemable after December 1, 1920, at the price of 110% of its par value (Tr., p. 10). The Preferred Stock B is entitled to preferential dividends in each fiscal year up to five per cent. after payment of the full five per cent. dividend on the Preferred Stock A but before any dividend shall be paid upon the Common Stock (Tr., pp. 10, 11). All three classes of stock have equal voting rights (Tr., p. 19).

For convenience, the pertinent part of the text of the certificate for the Preferred Stock A and the corresponding text of the Certificate of Incorporation are set out in the subjoined Appendix p. 49.

The foregoing indicates the salient features of the financial structure of the Railway Company.

In every fiscal year from the date of the organization of the Railway Company to the year 1926, excepting two years, there were net earnings. In certain of these years, however, the Board of Directors declared no dividend on the Preferred Stock A or declared a dividend at a rate lower than 5%. (Tr., pp. 4; 21; 22; 40). It was the judgment of the Board of Directors that these earnings ought not to be used for the payment of dividends but should be applied to the development and improvement of the property which had only recently emerged from receivership (Tr., pp. 21; 22). The bill of complaint does not challenge the good faith or the propriety of this action of the Board of Directors. On the contrary, the bill of complaint itself avers that the entire amount thus applied "was carried to the surplus of the Railway Company *and used for additional working capital and for other proper corporate purposes.*" (Italics ours). (Tr., Complaint Par. Tenth, p. 5).

The answer of the Railway Company, which stands admitted by the plaintiff's motion for a decree on the pleadings, contains the following allegation:

"The Railway Company admits the allegations contained in paragraph Eighth of the Complaint respecting the payment and non-payment of dividends between the years 1915 and 1926, but it denies that there were large net earnings available for dividends on its Preferred Stock 'A' in the period mentioned in said paragraph and denies that its earnings in any part or parts of said period justified the payment of any dividends which were not actually paid, and, although admitting balances of net earnings in certain non-dividend periods over expenses and prior charges, the Railway Company denies that any part of such balances could, consistently with its lawful obligations to its stockholders, or with its duties to the public in safe and efficient maintenance of property and service, or with sound discretion and the duty of its directors, have been distributed to stockholders, and avers that its entire surplus earnings of all periods since the incorporation of the Railway Company not actually distributed to stockholders and not reserved for working capital or necessary corporate requirements has been actually appropriated to and is now represented by fixed and permanent improvements and additions to the property and equipment of the Railway Company to enable it adequately to discharge its public duties and protect its property, and that no part of such alleged surplus is represented by any cash or liquid fund or by any accumulation of cash assets available for dividends" (Tr., pp. 21-22).

It is thus alleged in the answer and admitted by the respondents that no part of the earnings of non-dividend years could consistently, with the lawful obligations of the Railway Company to its stockholders and of its duties to the public in safe and efficient maintenance of property and service or with the sound discretion and duty of its Directors, have been distributed to stockholders, and that its entire surplus earnings of all periods since its incorporation, not actually distributed to the stock-

holders and not reserved for working capital or necessary corporate requirements, has been actually appropriated to and is now represented by *fixed and permanent improvements and additions to the property and equipment of the Railway Company to enable it adequately to discharge its public duties and protect its property and that no part of its alleged surplus is represented by any cash or liquid fund or by any accumulation of cash assets available for dividends* (Tr., pp. 21; 22).

III.

The Underlying Legal Question.

Stated broadly, the question now presented to this Court is whether the Preferred Stock A of the Railway Company which by its express terms is non-cumulative is nevertheless cumulative *quo ad* any net earnings accruing in non-dividend or partial dividend years which the Board of Directors (elected by the preferred and common stockholders with equal voting rights, and with the preferred stockholders always in the majority) in the exercise of an unquestioned discretion determined should not be distributed but should be invested, and which have actually been invested, in the property or held for working capital.

In asking that such quasi-cumulative character be given to the Preferred Stock A of Wabash Railway Company, the respondents—as we understand their position—do not rely upon any special or unusual stipulation in the Preferred A stock contract but rely entirely upon what they conceive to be the right as a matter of general law of the holders of a non-cumulative preferred stock.

The petitioners contend that the right thus claimed by the respondents (a) is not an ordinary incident of non-cumulative preferred stock, and (b) regardless of the rule governing non-cumulative stock in ordinary cases is a right which is definitely excluded by the terms and provisions of the Preferred A Stock of Wabash Railway Company.

ARGUMENT.

I.

In the absence of language creating a different obligation, the holders of a non-cumulative Preferred Stock who do not become entitled by appropriate declaration to dividends for a particular fiscal year, have no right to require that dividends for such year be added to the dividends declared for a subsequent year.

Wabash Railway Company is a corporation of the State of Indiana, but there is no statute of that State or controlling decision of its Courts which takes the case out of the application of general principles.

One of the earliest cases in this Court involving non-cumulative Preferred Stock is *Bailey* v. *Railroad Company*, 17 Wallace 96 (1872).

This case related to non-cumulative Preferred Stock issued by the Hannibal and St. Joseph Railroad Company and the point in controversy was whether or not the Preferred Stock and Common Stock participated *pro rata* in the year's surplus after the payment of the full non-cumulative preferred dividend. The following is from the opinion of Mr. Justice Clifford (p. 109):

> "Holders of preferred stock, as there provided, are entitled to receive all the net earnings

> of the company *which may be divided* (our italics) pursuant to the indenture in each year up to $7 per share, and to share in any surplus beyond $7 per share *which may be divided* (our italics) upon the common stock, which in substance and legal effect is the same regulation as that contained in the circular or plan, and all the other writings upon the subject which were given in evidence at the final hearing."

It is to be noted that even at this early date it was clearly understood that the rights of the non-cumulative Preferred Stock like those of Common Stock related to earnings that were *divided* and not to earnings that were withheld from distribution by directors in the exercise of sound discretion.

The principles of law governing the rights of non-cumulative Preferred Stock are clearly set forth in the opinion of this Court in *New York, Lake Erie & Western Railroad Company* v. *Nickals*, 119 U. S. 296 (1886).

At the outset it therefore becomes important to analyze this decision and to indicate what was decided and the reasons therefor and its bearing upon the case now presented to this Court.

The New York, Lake Erie & Western Railroad Company was organized to acquire at a foreclosure sale pursuant to a plan and agreement of reorganization, properties theretofore owned by the Erie Railroad Company. The plan and agreement provided for an issue of Preferred Stock "entitling the holders to non-cumulative dividends, at the rate of six per cent. per annum, in preference to the payment of any dividend on the Common Stock, but dependent on the profits of each particular year as declared by the Board of Directors."

In the Articles of Association of the reorganized Company, it was provided that the holders of the Preferred Stock shall be entitled to "non-cumulative dividends at the rate of six per cent. per annum in preference to the

payment of any dividend on Common Stock''—the words "but dependent on the profits of each particular year, as declared by the Board of Directors'' being omitted.

While this Court thought that the omission of these words from the Articles of Association was significant, it reached its decision "independently of this view'' (pp. 304, 305).

The facts were:

The new company was organized in 1878. On December 9, 1880, the directors submitted a report of operations for the fiscal year ending September 30, 1880, showing net earnings from traffic of $7,049,183.51 and total net earnings of $7,833,140.16. Deducting interest and fixed charges, there remained "a net profit from operations of the year of $1,790,620.71''. The directors said that this amount had been applied "to the building of double track, erection of buildings, providing additional equipment, acquiring and constructing docks at Buffalo and Jersey City and to the addition of other improvements to the road and property''. The preferred stockholders sued to compel the payment of the non-cumulative preferred dividend on the theory that the net profit for the fiscal year ended September 30, 1880, constituted a fund applicable primarily to the payment of the 6% dividend on the preferred stock and that it was a breach of trust to apply it otherwise (p. 302).

This view was sustained by the Court below which held (15 Fed. Rep. 575):

> "The question becomes more one of right, to be determined by the law, than one of policy, to be determined by the discretion of the directors. Here were profits in fact; the preferred stockholders had rights dependent upon this fact. These rights could not lawfully be passed by for the benefit of other interests, however intimately connected, any more than any other property of the preferred stockholders could be appropriated to

the same purpose, on the ground that such appropriation of it would be for the best good of the whole."

The Court below also said:

"Here these dividends are non-cumulative, and if the holders of this stock do not get these dividends in each particular year they never can have them. The improvement of the property by the expenditure of the money belonging to them goes to the benefit of the other owners, and not to them, so long as it would pay the dividends on the preferred stock without the expenditure."

This decision was unanimously reversed by this Court, which in an opinion by Mr. Justice Harlan said (p. 305):

"What was stipulated to be paid to them as holders of preferred stock in the new company was not a *debt,* payable in every event out of the general funds of the corporation, but a *dividend,* 'as declared by the board of directors,' and payable out of such portion of the profits as should be set apart for distribution among shareholders; non-cumulative, because 'dependent on the profits of each particular year,' and not to be fastened on the profits of succeeding years. That the parties contemplated a declaration of a dividend, and not a mere statement of net profits during a designated period is made evident by the requirement that 'dividends' to preferred stockholders should be paid 'in preference to the payment of any dividend on the common stock'. This language is not consistent with the theory that the holders of preferred stock were entitled to six per cent. thereon simply because there were profits, and irrespective of any declaration of a dividend. A declaration of profits, as, in itself, and without further action by the directors, entitling shareholders to dividends, is unknown in the law or in the practice of corporations. Dividends are 'declared' by some formal act of the corporation—the question

whether there are or are not profits being settled entirely by the accounts of the company as kept by subordinate officers, not by the mere statement of directors as to what appears upon its books.

A different view would lead to results which sound policy would seem to forbid, and which, therefore, it is not to be supposed were contemplated by the parties. For, if preferred stockholders become entitled to dividends upon a mere ascertainment of profits for a particular year, the duty of the company to maintain its track and cars in such condition as to accommodate the public and provide for the safe transportation of passengers and freight would be subordinate to their right to payment out of the funds remaining on hand after meeting current expenses and fixed charges. Indeed, there is some ground to contend that, according to appellees' interpretation of the charter, the directors were not at liberty, in any year when the current receipts were in excess of operating expenses, to pay even interest on funded debt, or rentals of leased lines, before paying a dividend on preferred stock. We are of opinion that while the agreement of 1877 and the articles of association sustain the claim of preferred stockholders to a six per cent. dividend in advance of common stockholders, the former are not entitled, of right, to dividends, payable out of the net profits accruing in any particular year, unless the directors of the company formally declare, or ought to declare, a dividend payable out of such profits; and whether a dividend should be declared in any year is a matter belonging in the first instance to the directors to determine, with reference to the condition of the company's property and affairs as a whole. As the evidence shows that the profits for the year ending September 30, 1880, were applied to objects that were legitimate and proper, and as the condition of the company was not such as to make the declaration of a dividend a duty upon the part of the directors, we perceive no ground upon which the claim of the appellees can be sustained."

The broad underlying principle of this decision is that the *right* of the preferred stockholder to a dividend is derived from a declaration by the Board of Directors who are to determine in the exercise of their sound discretion whether earnings shall be invested in plant or equipment or held for working capital or shall be distributed by way of dividends to stockholders. When the Board of Directors duly and in good faith determines to invest earnings of a particular dividend period in plant and equipment or to appropriate the same for working capital, the preferred stockholder is concluded by the action of the Board of Directors and if his stock is non-cumulative his dividend for this period is "not to be fastened on the profits of succeeding years".

It is submitted that this principle necessarily controls the present case.

The Board of Directors of Wabash Railway Company in the early period following reorganization, not only did not declare preferred dividends but determined to invest earnings in plant and equipment, a determination which forecloses any claim by the preferred stockholders against such earnings unless the action of the Directors involved an abuse of discretion, which it is conceded is not the case.

What the right, if any, of the preferred stockholder would be if the Board of Directors should subsequently change its policy and determine to distribute earnings theretofore withheld from the preferred stock is a question which does not arise in the present case. This is not a case where earnings previously invested in the property of the Railway Company or held for working capital are released from such appropriation and are to be distributed in whole or in part. This is a case where these investments are still held intact and not distributed and where the preferred stockholder is seeking to establish

an equitable lien or credit against invested surplus and thereafter to require the invested surplus to be liquidated for his account by the use of subsequent earnings; in short it is a case where the preferred stockholder is seeking to do what this Court in the *Nichols* case said he could not do, namely, *fasten* an undeclared non-cumulative dividend on the profits of succeeding years.

In his dissenting opinion in the Circuit Court of Appeals, Circuit Judge Learned Hand seems to assume that if the Directors hereafter should wish to reduce the working capital accumulated out of past earnings, they would probably be obliged to declare as preferred dividends the amount so withdrawn. Whatever plausible reasons may be assigned for this assumption, in support of which Judge Hand refers to two cases considered at a subsequent point in this brief, the question of what the rights of non-cumulative preferred stockholders would be in a dividend distribution of such a fund does not arise in this case, and is not now before this Court. It is, however, definitely settled that undivided earnings must be distributed "as capital assets" in the event of liquidation.

This Court so held in *Continental Insurance Company v. United States*, 259 U. S. 156 (1921).

In many aspects this case, which arose out of proceedings under the Federal Anti-trust laws against the Reading Company, is of such controlling importance that reference may appropriately be made to Poor's Manual of Railroads for the financial history of the Reading Company. (See Poor's Manual of Railroads; 1897-1922; 1928; Tr., p. 42).

The Reading Company was reorganized under the laws of Pennsylvania in December, 1896, with three classes of stock, viz.:

$28,000,000	4% Non-cumulative First Preferred Stock
42,000,000	4% Non-cumulative Second Preferred Stock
70,000,000	Common Stock

The Organization Agreement under which the Company was reorganized, provided that the Preferred Stock should be entitled to non-cumulative dividends

> "at the rate of, but not exceeding, four per cent per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year, of any dividend on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the First Preferred Stock, there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

In each of the years 1897 to 1900 inclusive, there were net earnings which might have been distributed as dividends on the Preferred Stock but no dividend was declared until 1900, in which year $1,227,335.35 was earned and a dividend of 3% (1% less than the full rate) amounting to $839,736, was declared and paid upon the First Preferred Stock. No dividend was paid on the Second Preferred Stock until 1903, when 1½% was declared. The full 4% dividend upon the First Preferred

Stock was declared in 1901 and on the Second Preferred Stock in 1904 and thereafter dividends at this rate were maintained. Dividends at varying rates were paid on the Common Stock between 1905 and 1912 and after 1912 dividends amounting to 8% annually were regularly declared upon the Common Stock.

The Reading Company having been adjudged to be an unlawful combination, was required by a decree of the District Court entered under mandate of this Court to distribute to stockholders certain assets representing accumulated earnings. From this decree certain Common stockholders appealed to this Court. This Court held that the effect of the decree was "in fact and in law a liquidation of the assets of the old Reading Company and a *pro rata* distribution of assets among the holders of the First Preferred Stock, Second Preferred Stock and Common Stock."

This Court approved this method of distribution as consistent with the contract rights of the respective stockholders and rejected a claim of the Common Stock to participate in the distribution to the exclusion of the Preferred Stocks.

The following is from the opinion of this Court, written by Mr. Chief Justice Taft:

> "It will be observed that the preferred stock and the common stock with 1,400,000 shares of each were thus given an equality of voting power which could not be changed without the consent of the company, and that it has not been changed either by conversion or redemption. This would seem to have been designed to preserve an equilibrium of control in which reasonable dividends out of profits when they accrued in sufficient amount would be voted to the common stockholders on the one hand, and proper additions would be made out of earnings to the capital of the company to increase its future profit-earning capacity and create a greater security for a constant payment of

dividends to preferred stockholders. Of course there would not be block voting of the two classes of stock but the division did tend to secure a fair representation of both interests in the board of directors.

The effect of the agreement as to dividends upon the preferred and common stock seems to us clear. It emphasizes that dividends are to be paid only out of undivided profits and when and as determined by the board of directors and only if and when the board shall declare them. It leaves to the board to determine in its discretion whether the undivided profits shall be put in surplus working capital or in dividends. The limitations on the discretion of the board are that the first and second preferred can not receive more than four per cent. in any fiscal year, and that neither the second preferred nor the common stock can receive any dividend until the first preferred dividend has been paid in full each year and the common stock receives nothing until the second preferred dividend is thus paid. The words describing the condition upon which the power of the board to declare dividends on the common stock can be exercised, show that each year's profits are to be considered by themselves in the distribution of dividends between the stock.

Appellants, however, rely on the final words of the clause to show that it is intended that net profits in any past year can be thereafter allowed to the common stock if in that past year the preferred stock had been paid full dividends. We do not find it necessary to decide that the board of directors has not such power; but if so, the power is not one the exercise of which can be compelled in the absence of fraud or breach of trust. The failure of the board to exercise it, and the application of the earnings to surplus determine such earnings to be assets as of the time of the compulsory winding up and liquidation of the corporation. The power to declare dividends not exercised can have no more effect upon the rights of the preferred stockholders to share in the exist-

ing assets of the corporation when liquidated than the failure of the company to convert preferred stock into common, or to redeem the preferred stock at par. The proper interpretation of the agreement is that, after the declaration of dividends for any current year, the undivided earnings are to be regarded as capital assets and to be distributed on liquidation, unless the board of directors has meantime applied them as dividends. If the argument of appellants were carried to its logical result, all the net earnings of the Reading Company in twenty-five years no matter how invested or applied to increasing the earning capital, must in a liquidation be treated as undistributed profits to go entirely to the common stock without any action of the board of directors. This is impossible."

In its essential features, this decision is irreconcilable with the claim now asserted by the Preferred A stockholders of Wabash Railway Company.

It is to be noted:

(a) In the years in which dividends upon the Preferred Stock of the Reading Company were not paid or were paid only in part there were substantial net earnings withheld from distribution and used for corporate purposes.

(b) Dividends upon the Second Preferred Stock were inaugurated in 1903 and were continued until the segregation without any payment being made to the First Preferred stockholders in respect of the years in which the First Preferred dividend, though earned in whole or in part, was not declared by the Board of Directors.

(c) Dividends upon the Common Stock were inaugurated in 1905 and were continued until the segregation without any payment being made to either issue of Preferred Stock in respect of the non-dividend or partial dividend periods.

(d) *The corporate surplus representing earnings withheld from distribution to all classes of stock was treated by this Court as assets to which no dividend credits or preferential equities attached and which was decreed to be distributed pro rata among all three classes of stock.*

The financial structure of the Reading Company is typical of those of most of the great railroad transportation companies in the country. These companies were nearly all organized or reorganized subsequent to the decision of this Court in the *Nickals* case with one or more issues of Preferred Stock which were either wholly non-cumulative or non-cumulative for a stated period of years after organization or reorganization. The underlying purpose of such a financial structure was to give to the Board of Directors discretionary power and authority freely to use corporate earnings in building up these properties to the standards necessary to enable them to discharge their public obligations—and it was a necessary and vital feature of a financial structure thus conceived that if in any year the Board of Directors found it necessary to apply to working capital or other corporate purposes income which otherwise might have been used for dividends the non-cumulative preferred stockholder was not entitled to any dividend distribution for that year but was to be compensated for his loss of income by the increased earning power of the corporation and the "greater security for a constant payment of dividends to the preferred stockholders". A list of the more important railroad companies with issues of non-cumulative preferred stock outstanding, is set out in the subjoined footnote.* This footnote has been compiled from

* Note: The Atchison, Topeka and Santa Fe Railway Company $124,199,500 5% non-cumulative Preferred Stock; Boston and Maine Railroad Company $38,817,900 non-cumulative Preferred Stock; Baltimore and Ohio Railroad Company $58,863,181 4% non-cumulative Preferred Stock; Buffalo, Rochester and Pittsburgh Railway

data contained in Poor's Manual of Railroads and Moody's Manual of Railroads which "are standard publications in general use for statistical purposes and are generally relied upon as accurate" (Tr., p. 40). From this data it appears that many of the companies—particularly in the earlier years—have pursued the same policy that was adopted by the Reading Company and the Wabash Company—the conservative policy of building up plant and equipment by the use of surplus earnings. Many companies, after building up their properties by the use of earnings accruing in years in which dividends were not declared upon the non-cumulative Preferred Stocks—as did the Reading Company and Wabash Railway Company—placed non-cumulative Pre-

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Company 6% non-cumulative Preferred Stock; Chicago & Alton Railroad Company $19,544,000 4% non-cumulative Preferred Stock; Chicago and Eastern Illinois Railway Company $22,046,000 6% Preferred Stock, non-cumulative prior to January 1, 1924; Chicago Great Western Railroad Company $47,133,002 4% Preferred Stock, non-cumulative prior to June 30, 1914; Chicago, Indianapolis & Louisville Railway Company $4,991,300 4% non-cumulative Preferred Stock; Chicago, St. Paul, Minneapolis and Omaha Railway Company $11,259,859 7% non-cumulative Preferred Stock; Cleveland, Cincinnati, Chicago & St. Louis Railway Company $9,998,500 5% non-cumulative Preferred Stock; Colorado & Southeastern Railroad Company $8,500,000 4% non-cumulative First Preferred Stock; $8,500,000 4% non-cumulative Second Preferred Stock; Duluth, South Shore & Atlantic Railway Company $10,000,000 6% non-cumulative Preferred Stock; Erie Railroad Company $47,904,400 4% non-cumulative First Preferred Stock; $16,000,000 4% non-cumulative Second Preferred Stock; Gulf, Mobile & Northern Railroad Company $1,415,600 6% Preferred Stock, non-cumulative prior to January 1, 1920; Kansas City Southern Railway Company $21,000,000 4% non-cumulative Preferred Stock; Minneapolis, St. Paul & Sault Ste. Marie Railway Company $12,603,400 7% non-cumulative Preferred Stock; Missouri-Kansas-Texas Railroad Company $45,884,623 7% stock, non-cumulative prior to January 1, 1928; Norfolk and Western Railway Company $22,992,300 4% non-cumulative Adjustment Preferred Stock; Pere Marquette Railway Company $12,429,000 5% Preferred Stock, non-cumulative prior to January 1, 1919; St. Louis-San Francisco Railway Company $7,145,100 6% non-cumulative Preferred Stock; St. Louis Southwestern Railway Company $16,000,000 5% non-cumulative Preferred Stock; Seaboard Air Line Railway Company $37,300,000 6% non-cumulative Preferred Stock; $23,894,100 4.2% non-cumulative Preferred Stock; Southern Railway Company $60,000,000 5% non-cumulative Preferred Stock; Union Pacific Railroad Company $99,543,500 4% non-cumulative Preferred Stock; Western Maryland Railway Company $8,561,000 4% non-cumulative Preferred Stock; Wheeling and Lake Erie Railway Company $11,882,600 7% Preferred Stock, non-cumulative prior to November 1, 1916; $10,334,958 6% non-cumulative Preferred Stock.

ferred Stocks upon a dividend basis and also inaugurated dividends upon junior stocks.†

That the mere realization of net earnings in non-dividend or partial dividend years should result in the creation of a dividend credit giving cumulative rights *pro tanto* to non-cumulative Preferred Stock is, we submit, an idea developed recently and directly traceable to a misinterpretation of decisions which do no more than give effect to the special statutory law and policy of the State of New Jersey.

For this reason an analysis of these decisions seems appropriate:

Bassett v. *U. S. Cast Iron Pipe & Foundry Company*, 74 N. J. Eq. 668. Aff. 75 N. J. Eq. 539 (1909);

Moran and Day v. *U. S. Cast Iron Pipe & Foundry Company*, 95 N. J. Eq. 389 (1924);

Moran v. *U. S. Cast Iron Pipe & Foundry Company*, 96 N. J. Eq. 698 (1924);

Day v. *U. S. Cast Iron Pipe & Foundry Company*, 96 N. J. Eq. 736 (1924).

Section 18 of the New Jersey Corporation Act, after authorizing corporations to issue Preferred Stock, provides as follows:

> "The holders thereof shall be entitled to receive and the corporation shall be bound to pay thereon a fixed yearly dividend to be expressed in the certificate, not exceeding eight per centum, pay-

†Note: The companies in this category include the Buffalo, Rochester and Pittsburgh Railroad Company; Chicago, Indianapolis and Louisville Railway Company; Chicago, St. Paul, Minneapolis & Omaha Railway Company; Cleveland, Cincinnati, Chicago and St. Louis Railway Company; The Colorado & Southern Railway Company; Erie Railroad Company; The Kansas City Southern Railway Company; Minneapolis, St. Paul, Sault Ste. Marie Railway Company; Norfolk & Western Railway Company; Southern Railway Company; Union Pacific Railroad Company. This list is limited to railroad companies and even as to these does not purport to be complete. There are certainly hundreds of industrial companies similarly situated.

able quarterly, half yearly or yearly, before any dividend shall be set apart or paid on the Common Stock."

This section was amended in 1901 by the addition of the following:

> "and such dividends may be payable before any dividends shall be set apart or paid on the Common Stock and such dividend may be made cumulative; *provided the corporation shall set apart or pay the said dividends to the holders of the non-cumulative Preferred Stock before any dividends shall be paid on the Common Stock.*"

In addition, Section 47 of the Corporation Act of 1896, provided:

> "The directors of every corporation created under this Act shall in January of each year * * * after reserving over and above its capital stock paid in, as a working capital for said corporation, such sum, if any, as shall have been fixed by the stockholders declare a dividend among its stockholders of the whole of its accumulated profits exceeding the amount so reserved."

The certificates for the Preferred Stock of the United States Cast Iron Pipe & Foundry Company, which were issued under and subject to the above statutory provision, stipulated that the holders shall be "entitled out of any and all surplus net profits, whenever declared by the Board of Directors, to non-cumulative dividends at a rate not to exceed 7% per annum" and if "after providing for the payment of full dividends for any fiscal year on the Preferred Stock, there shall remain any surplus net profits for such year, any of such net profits of *such* year and any other fiscal year after full dividends shall have been paid on the Preferred Stock, shall be applicable to * * * dividends upon the Common Stock".

The Cast Iron Pipe Company had accumulated a reserve for working capital amounting to $2,459,000 from surplus net profits for the years 1900 to 1906 inclusive. Of this reserve $1,593,000 was obtained by scaling down the dividends on the Preferred Stock below the 7% specified in the charter and certificate in four of these years. The company declared a dividend upon the Preferred Stock for the years in which the dividend was scaled down below 7%, such dividend to be paid out of the reserve withheld from the preferred stockholders.

Bassett, a common stockholder, brought suit to enjoin payment of the dividend, contending that dividends on Preferred Stock must be paid out of profits made during the year and that if any such profits were not distributed in that year, they belonged to the common stockholders. The Cast Iron Pipe Company contended that it might pay dividends on the Preferred Stock out of any surplus net profits. The Court of Errors and Appeals held that neither contention was altogether sound; that the corporation could not accumulate a reserve out of earnings which otherwise would be paid as dividends on Common Stock and afterwards use it to pay dividends on Preferred Stock in a year when net profits were insufficient. On the other hand, when a reserve was accumulated by cutting down dividends which otherwise would have been paid to preferred stockholders, such fund so far as it represented moneys so retained, could be availed of for the payment of subsequent dividends on the Preferred Stock.

The Cast Iron Pipe Company continued to accumulate a working capital reserve and at the end of the fiscal year 1922 the amount withheld from the Preferred Stock was $700,000 and from the Common Stock $1,800,000. In 1922 the earnings were over $1,000,000 and after paying a dividend of 5% ($600,000) on the Preferred Stock, the balance ($559,000) was transferred to working capital re-

serve. Later a further dividend of 2% was declared for 1922 and the amount ($240,000) was withdrawn from working capital reserve in order to pay it. In November, 1923, the directors voted to pay the preferred stockholders an additional dividend of one-half of one per cent. and a like dividend upon the Common Stock, these dividends to be drawn from the working capital reserve. The resolution declaring the dividend stated that the amount was no longer needed as working capital and after stating that a dividend of 7% had been paid to the preferred stockholders for 1922, further stated that the payment was out of the net earnings for that year.

Moran, a common stockholder, sued to enjoin the payment of the additional dividend to the preferred stockholders. Day, a preferred stockholder, sued to enjoin the payment of the dividend to the common stockholders. Vice-Chancellor Backes held that the resolution declaring the dividends of the preferred stockholder was lawful, and the Moran bill was dismissed. Referring to Section 18 (supra), the Vice-Chancellor said:

> "This obviously means, as to non-cumulative dividends, that out of the profits of any fiscal year not more than the percentage fixed by the charter shall be paid on such stock for such year, but it does not prohibit the company, after having paid the fixed yearly dividend, from, in the same year, declaring and paying additional dividends out of profits earned in prior years applicable to dividends for such years and which, but for holding them in reserve for economic reasons, would have been distributed in dividends in those years. These profits belong primarily to the preferred stockholders and the directors are in no wise restricted either as to amount, time or occasion when distribution shall be made."

This decision of Vice-Chancellor Backes was unanimously affirmed by the Court of Errors and Appeals (96 N. J. Eq. 698).

In the *Day* case, Vice-Chancellor Backes held that the language of the statute was unmistakable; that the "legislative scheme was to protect the preferred stockholders in their priority rights to dividends over the common stock in all events". The Vice-Chancellor concluded:

> "The statutory ban on payments of dividends on the common stock, until the preferred stockholders have been awarded their just due, is explicit and imperative. The preference clauses in the certificate of incorporation, in so far as they are thus inconsistent with the statute are invalid."

Accordingly, the Vice-Chancellor held that the preferred stockholders were entitled to their preferred dividend as a matter of right, although the time when the obligation was to be performed was largely a matter of discretion with the directors. They could pass dividends if they thought it necessary—"but once having decided to divide the profits, duty supplants discretion, and it becomes incumbent upon the directors to discharge the company's obligation to pay the fixed yearly dividends, and this before any dividend shall be set apart or paid on the common stock, viz. to holders of cumulative dividend shares, all arrearages; to holders of non-cumulative dividend stock, the dividends withheld".

The preferred stockholders were entitled to the reserve profits and "the statutory design was to meet just such a situation as here confronts the preferred stockholders". Accordingly, the dividend to the common stockholders before the preferred stockholders had been paid was held to be unlawful and was enjoined.

This decision was affirmed by a divided Court, seven judges voting for reversal (96 N. J. Eq. 736). The opinion written by Judge White is not the opinion of the Court but is published "as expressing the views of the members of the Court who voted for affirmance", there

being an equal number who voted for reversal. But in writing for affirmance, Judge White noted that the stock in question was preferred within the meaning of the statute and that to allow a dividend upon the Common Stock "while earned available but withheld dividends upon the Preferred Stock for previous years remained undistributed in the surplus of the corporation" would be in conflict with the "legislative scheme or policy".

Judge White construed the corporation's charter to be in conformity with this legislative policy and then stated:

> "There remains for consideration but one point, viz.: Has the status of these preferred stock unpaid dividends for previous years been so fixed and ascertained as available net profits for dividend purposes by action of the Board of Directors as to vest in the preferred stockholders the right here sought to be enforced? We think it has. We fully realize that a mere allegation that dividends have been earned is not sufficient, for in the absence of fraud, actual or constructive, (neither of which is here charged), the dividend rights of stockholders whether preferred or common, are dependent in this respect upon affirmative action of the Board of Directors. * * * But this is not an attempt to force the payment of an undeclared dividend on the preferred stock. The effort here is to prevent the payment of a dividend on the common stock in violation of the priority rights of the preferred shareholders."

This case, while establishing the right of the preferred stockholders of the Cast Iron Pipe Company under the New Jersey statute, does not sustain the claim that in every case where amounts of earnings in prior years have been devoted to proper corporate purposes the preferred stockholders have a substituted lien on subsequent earnings so that they may not be distributed as provided in the certificate of incorporation.

It should not be overlooked that in none of the three New Jersey cases is a single authority except the New Jersey statutes cited in support of any major proposition. The cases are valueless as authority outside of the State of New Jersey. Indeed, it is doubtful whether the cases are even authoritative as a final interpretation of the New Jersey statutes in view of the fact that in the last of the three cases, seven out of fourteen judges did not accept Judge White's view and voted to reverse the judgment.

In 1923 an article by A. A. Berle, Jr., entitled "Non-cumulative Preferred Stock" was published in the Columbia Law Review*. In this article the author on authority of the case of *Bassett* v. *U. S. Cast Iron Pipe & Foundry Company* (supra) asserts that "non-cumulative Preferred Stock carries far greater rights than are usually supposed; that in disregard of these rights many dividends in stock and cash have been paid improperly, with resulting liabilities against those declaring them; that market valuation, corporate accounting and corporate dividend policies in connection with such stock should to some extent be revised". Specifically it is maintained in this essay that earnings withheld from distribution to non-cumulative Preferred Stock do not, as this Court held in *Continental Insurance Company* v. *United States* (supra), constitute assets divisible *pro rata* among stockholders on dissolution, but constitute a special preferred fund which must be segregated on the corporate books for the benefit of Preferred Stock. It is admitted by the essayist that the establishment of a preferred surplus fund will create novel accounting problems with which the Courts "may eventually have to wrestle" but it is urged that these problems are susceptible of a solution favorable to the non-cumulative Preferred Stock.

* 23 Columbia Law Review 158.

This article was followed by editorial comment in the student law reviews asserting on behalf of non-cumulative Preferred Stock rights of which during the forty-year period following the decision of this Court in the *Nickels* case judges, lawyers and accountants alike had been unaware.* This result is sought to be accomplished by evolving or construing from the decisions arising under the statutes of New Jersey a new definition of non-cumulative stock which, if generally applied, would give a meaning different from that commonly understood and heretofore accepted, resulting in widespread disturbance of property rights long vested.

That the Circuit Court of Appeals was influenced by these purely theoretical discussions is manifest from the prevailing opinion written by Circuit Judge Manton (Tr., p. 79).

It is submitted that the conclusions are unsupported by authority and are unsound.

The term "non-cumulative" is descriptive rather than technical; it was devised to describe a stock or bond upon which dividend or interest charges do not accumulate, so as to require liquidation before payment of dividends on junior issues. In short, "non-cumulative" was the negative of "cumulative" and has been so understood for more than half a century.† As well stated in a

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* 27 Columbia Law Review 88 (1927); 36 Yale Law Journal 457 (1927); 11 Virginia Law Review 622 (1925); 76 University of Pennsylvania Law Review 618 (1928). See, however, the countervailing criticism in 12 Cornell Law Quarterly 341 (1929) and 38 Yale Law Journal 1019 (1929).

† Cook, Law of Corporations, (Ed. 8, 1923) 2272.

"When preferred stock is issued it is generally specified in the certificate itself whether it is 'cumulative' or 'non-cumulative'. In the former case all arrears of dividends must be paid on the preferred stock before any dividend is paid on the common. In the latter case the contrary is the rule."

Black's Law Dictionary:

"In the case of 'non-cumulative' preferred stock, its preference for any given year is extinguished by the failure to earn or pay the dividend in that year."

recent review of the present case published in the Cornell Law Quarterly:

> "The terms were considered antithetical. It was the prevalent view and it exists now that a holder of non-cumulative stock had no better right to claim withheld profits than the holder of Common Stock; but if the Directors in their discretion declared a dividend out of current profits the non-cumulatives were entitled to a preference for that fiscal year since." (16 Cornell Law Quarterly 261).

The fact that such has been the common understanding and interpretation of the word during a long period in which vast property rights have vested on the faith thereof permanently fixes its meaning in our law so that any new conception or new definition, unless created by statute or express contract, which alters the word and understanding such property rights must at once be rejected. It is a rule firmly embedded in our jurisprudence that judicial decisions under which property rights have vested will be adhered to, their inherent correctness or incorrectness in the abstract being of less importance than that the rule of property so established should be constant and invariable. (15 Corpus Juris 974). By like principle, the legal significance of language upon which property rights have vested over a long period of time should be held inviolate by the Courts.

Underlying all of the recent scholastic discussions there is but one idea, namely, that a specific equity in undistributed earnings must be given to non-cumulative preferred stockholders in order to protect them from oppression on the part of the common stockholders who ordinarily control the Board of Directors. That common stockholders when they control the Board of Directors (which is not always the case and is not this case) may be tempted to build up corporate property at the expense of non-cumulative preferred stockholders is not a new idea. Apparently the same idea was prominent in

the mind of the Federal Judge whose decision nearly fifty years ago was reversed by this Court in the *Nickels* case. The obvious answer, as pointed out by Circuit Judge Learned Hand in his dissenting opinion in the present case, is that "the law has long advised them that their rights depend upon the judgment of men subject to just (but possible) bias".

That such a speculative argument should be permitted to strike at the very foundation of the law of contracts could seem unthinkable in any case, but manifestly has no legitimate place in the discussion of the relative rights of stockholders in the present case. At the time of the organization of Wabash Railway Company, the Preferred Stock outvoted the Common Stock by two to one and as late as May 1, 1927, there were 693,330.50 shares of Preferred Stock A outstanding as against only 666,977.75 of Common Stock, all of the Preferred Stock B having been converted and extinguished, excepting 24,211.42 shares (Tr., p. 2). During the entire period covered by this litigation, preferred stockholders were unembarrassed by any statutory or contract requirement for cumulative voting and were entitled to elect, and presumably did elect, the entire Board of Directors.

Obviously, the dividend policy was not dictated by the Common Stock, but was the policy sponsored by the Preferred Stock. It appears from the record that during this period there were earnings of $45,563,996., out of which dividends were paid to the Preferred A stockholders in the amount of $8,562,011, and dividend credits were claimed in the amount of $16,127,250, leaving earnings of $21,077,235. applicable to 24,211.42 shares of Preferred Stock B and 666,977.75 shares of Common Stock (Tr., pp. 66-67). It is apparent, therefore, that the present corporate surplus of the Railway Company has been built up at a greater sacrifice of income on the part of the common stockholders than on the part of the holders of

the Preferred Stock A. Moreover, notwithstanding that the contribution of the Preferred Stock A to the prosperity of the Railway Company falls short of that of the Common Stock, the Preferred Stock A is a participating stock and is entitled to share equally with the Common Stock in any distribution of excess earnings.

The possibility that other corporations may have different financial structures with Common stockholders in the majority who may be tempted at times to oppress and depress the non-cumulative Preferred Stock is—if not remediable in the Courts, (which we do not admit)—no justification for re-making of the law of contracts and completely emasculating the sound financial structure of Wabash Railway Company.

The first step in the organization or reorganization of a corporate enterprise is the provision of capital and it developed at an early period that capital did not seek investment in common stocks junior to preferred issues upon which dividends were cumulative; it was found that the cumulative feature tended unduly to depress common stock, restrict its market and embarrass financing. Non-cumulative Preferred Stock was invented as a substitute,—the preferred stockholder to receive only such dividends as should be declared by the Directors in the exercise of a sound discretion except that in any year his preferential dividend must be provided for before any common dividend can be paid for that year. In many cases, perhaps in most cases, the non-cumulative preferred stock was taken by the same interests which purchased the Common Stock and was not marketed as a strictly investment stock until the corporate enterprise, through the judicious investment of current earnings, had been placed in a position strong enough to justify a permanent dividend policy. From data in Poor's Manual of Railroads, it appears that in railroad financing non-cumulative Preferred Stock has been the rule and cumulative Preferred Stock the exception, and it is highly

significant that during the long period which has elapsed since this Court decided the *Nickals* case, there is (a) no record in judicial decisions of a claim that Directors of any important Railway Company have failed to declare preferred dividends which ought to have been declared; (b) no record of the payment in any year by any such company of an extra dividend to non-cumulative Preferred Stock to clear previous "accumulations"; (c) no record of a case (save one that failed) where non-cumulative preferred stockholders have questioned the right of any such corporation to pay dividends on junior issues without first paying dividends earned but undeclared on non-cumulative Preferred Stock.

The exceptional case is *Norwich Water Power Company* vs. *Southern Railway Company*, 11 Virginia Law Register (N. S.) 203. This suit, brought by non-cumulative preferred stockholders of the Southern Railway Company to enjoin payment of dividends on Common Stock, was dismissed by Judge Beverly T. Crump, sitting in the Law and Equity Court of Richmond, Virginia. The exception is more apparent than real, as the case seems to have been inspired by the articles in the Columbia Law Review and the Virginia Law Review, to which we have heretofore referred. Upon the filing of Judge Crump's opinion, the preferred stockholders filed a petition for review by the Supreme Court of Virginia, which was denied. Subsequently, the Supreme Court permitted oral argument upon the question whether an appeal should be granted and after hearing oral argument, the Court again denied the petition. We quote the following from the opinion of Judge Crump:

> "Where the dividends are declared to be non-cumulative, that phrase carried with it the general idea that the dividend, if not declared and paid within any one year, although earnings exist for that year, is lost to the preferred stockholder; that is, that non-cumulative means that the right to the dividend is measured by the action of the

Board of Directors in any one year, and the failure to declare the dividend in any one year prevents it from accumulating as a further charge upon the earnings of the company then existing or which may be subsequently acquired."

The two-fold fallacy of this recent attempt to change the accepted view of non-cumulative Preferred Stock is that it both assumes a wrong and then provides an improper remedy.

As we have already observed, there has been little complaint of the good faith of railway company directors in dealing with non-cumulative preferred stockholders, but it is submitted that the remedy for an exercise of the discretion with which the directors have been invested by law and by which the preferred stockholder has contracted to abide is not an appeal to the Courts to reconstruct the contract. The remedy in such a case must be found within the corporate structure. For this reason, as pointed out by Mr. Chief Justice Taft in *Continental Insurance Company* v. *United States*, (*supra*), a sound financial structure preserves equilibrium of voting power between the different classes of stock.

II.

The language of the Preferred A Stock contract of Wabash Railway Company definitely excludes a construction under which the investment of earnings in improvements and equipment or working capital in non-dividend or partial dividend years operates as a permanent restraint against the distribution of earnings of subsequent years.

Assuming for purposes of argument that in the absence of language showing a contrary intent the term "non-cumulative" may be construed to mean "partly cumulative", it is submitted that such a construction is

foreclosed by the terms of the Preferred A Stock contract of Wabash Railway Company.

The Certificate of Incorporation and Preferred A Stock Certificate (Exhibits A and B to the Bill) both provide that the Preferred A Stock shall be

(a) Entitled to preferential dividends.

(b) in each fiscal year.

(c) before any dividend shall be paid upon other stock.

(d) but such dividend on the 5% Profit Sharing Preferred Stock shall be non-cumulative.

(e) That after the payment or setting apart in any one fiscal year of 5% dividends upon the 5% Convertible Preferred Stock B and upon the common stock of this corporation the 5% Profit Sharing Preferred Stock A shall be entitled to receive additional dividends at the same rate per cent. as any further or additional dividends which may be declared in that year upon such common stock.

(f) That upon liquidation holders of the Preferred A Stock are to be paid the full par value of their shares and "all dividends thereon *declared* and unpaid."

(g) That upon liquidation after payment to the Preferred Stock B and common stock of the par amount of their stock and all dividends thereon declared and unpaid holders of all classes of stock without priority or distinction shall share *pro rata* in the remaining assets of the corporation.

(h) That in event of the conversion of Preferred Stock "B" into Preferred Stock "A" and Common Stock there shall be "a proper adjustment of *declared* but unpaid dividends".

(i) That the 5% Convertible Preferred Stock B shall be entitled to receive preferential dividends in each fiscal year up to the amount of 5% after

payment of the full 5% dividends on the 5% profit sharing Preferred Stock A, but before any dividends shall be paid upon the Common Stock of the corporation.

The foregoing contract in each of its numerous subdivisions and in its entirety not only leaves free and untrammeled the broad discretion vested in the Board of Directors under the *Nickals* case, but clearly shows that accumulation of undeclared dividends could not have been contemplated by the parties.

It is to be noted:

(a) That the Preferred A dividend is "preferential" but not guaranteed or made a charge upon earnings.

(b) That each fiscal year is a separate accounting period and that the preference relates to each accounting period and is not general as in the case of cumulative stock.

(c) That the preference is limited to "dividends" implying the exercise of the ordinary directorial discretion in the creation of a definite legal right.

(d) That the "dividends" are to be "noncumulative," meaning, unless the context shows a different use, the negative of cumulative and as Black says, meaning that "its preference for any given year is extinguished by failure to earn or pay its dividend in that year."

(e) That an additional dividend may be paid upon the Preferred A after paying or setting apart the full dividend in the B stock and 5% on the common, but such additional dividend, like the preferential dividend, is dependent upon (1) a declaration by the Board exercising its discretion which (2) must be made in that year.

(f) That upon liquidation, holders of Preferred Stock A are to be paid the full par value of their shares "and all dividends thereon *declared* and unpaid"—the contract again invoking instead of fettering the ordinary discretion of the directors.

(g) That in like manner the Preferred B and Common Stock are to receive in liquidation the full amount of any "*declared* and unpaid" dividends.

(h) That in event of a conversion of B Stock into Preferred A and Common there is to be an adjustment "of *declared* and unpaid dividends," but if the present contention of the A stockholders is sound, why not an adjustment of *earned* and *undeclared* dividends? Clearly such a contingency was never contemplated by the author of the Preferred A contract.

(i) That by the letter of their contract to which all classes of stock are parties, the Preferred B stockholders are entitled to dividends in any year upon a single condition, namely, that the full 5% dividends shall have been paid upon the Preferred Stock A. In other words, by the letter of his contract, the Preferred B stockholder is entitled to receive payment of the dividend which is enjoined by the decision of the Circuit Court of Appeals.

It is respectfully submitted that the stipulation that the Preferred B stockholders are entitled to dividends up to 5% in any year in which the full 5% dividend is paid upon the Preferred Stock A is alone determinative of the present case.

Even if the Preferred Stock A was not expressly stated to be non-cumulative, this clear, definite stipulation that in any year the Preferred Stock B shall be entitled to receive 5% after payment of the full 5% dividend on the Preferred Stock A, would in and of itself

give full non-cumulative character to the Preferred Stock A. This right of the Preferred Stock B to its preferential 5% dividend conditioned *only* upon payment in the particular fiscal year of the full 5% dividend upon the Preferred Stock A is irreconcilable with the theory that prior payment of all dividends earned but unpaid upon the Preferred Stock A in previous years was also in the minds of the parties. To give such an interpretation to the contract, it is necessary to reconstruct it so that it will read as follows:

> "The holders of the Five Per Cent Convertible Preferred Stock B of the Company shall be entitled to receive preferential dividends in each fiscal year up to the amount of Five Per Cent after payment of the full Five Per Cent dividend on the Five Per Cent Profit Sharing Preferred Stock A, (and after further payment of all preferential dividends earned but unpaid thereon in previous years) but before any dividends shall be paid upon the Common Stock, but such preferential dividends shall be non-cumulative, and the holders of the Five Per Cent Convertible Preferred Stock B shall not be entitled to any other or further dividends in any fiscal year."

The addition of the stipulation in brackets works a fundamental change in the agreement of the parties and obviously is inadmissible.

Moreover, it is to be noted that both the Preferred A Stock and the Preferred B Stock are expressly stated to be "non-cumulative" and it is unreasonable to suppose that the term is employed in one sense as applied to the Preferred Stock A and in another sense as applied to the Preferred Stock B; it would be unreasonable to attribute partial or quasi cumulative character to the Preferred Stock A and to deny like character to the Preferred Stock B. It is provided, however, that the Preferred Stock B may receive dividends in any fiscal

year up to 5% but "shall not be entitled to any other or further dividends in any fiscal year". The purpose of this clause was to exclude the Preferred Stock B from participating with the Preferred Stock A and the Common Stock in excess earnings; but the language is unrestricted and is broad enough to exclude the Preferred Stock B from any additional dividend—even a dividend of past earnings. If, however, a postponed dividend of invested surplus earnings had been contemplated the right to receive such a dividend would have been guarded by appropriate language for both the Preferred Stock A and the Preferred Stock B. The use of the term non-cumulative in the same contract to express one idea as to the Preferred Stock A and a different idea as to the Preferred Stock B is foreclosed by elementary rules of construction. Obviously the term non-cumulative was intended to mean precisely what it says as applied to both of the two classes of stock.

There is a further stipulation which is equally incompatible with the theory of a dividend credit or a Preferred Stock surplus. Both the Preferred Stock A and the Preferred Stock B are redeemable at any time after December 1, 1920, at the fixed price of 110% of par. The redemption of either or both of these issues is not conditioned upon the liquidation of any dividend credit or the distribution of any preferred surplus fund, and again it is impossible to apply this new conception of non-cumulative Preferred Stock without interpolating still another clause into a contract drawn by parties who were themselves presumably thoroughly competent to express their own ideas; it becomes necessary to add to the redemption clause a stipulation that the right of redemption shall not be exercised "unless and until the corporation shall have paid all dividend accumulations upon the non-cumulative Preferred Stock so to be redeemed."

Arguments of this character could be multiplied indefinitely, but enough has been said to show that this recent conception of non-cumulative stock, if valid in any case, was not in the minds of the organizers of Wabash Railway Company.

Their purpose was clear.

The reorganized Company was to have two issues of Preferred Stock, each approximately of the same amount and each approximately equal to the amount of Common Stock.

At the outset, the two issues of Preferred Stock represented approximately twice the voting strength of the Common Stock and were in a position to elect the entire Board of Directors.

There could be no change in the voting control earlier than August 1, 1918, when the Preferred Stock B would become convertible, so that control of the Railway Company by its preferred stockholders was assured for at least three years.

After August 1, 1918, conversion of the Preferred Stock B into Preferred Stock A and Common Stock (one-half of each), would increase the voting strength of the Common Stock so that ultimately when all the Preferred B Stock was converted, voting power would be approximately evenly divided between Preferred Stock A and Common Stock. Inasmuch, however, as the conversion process would necessarily extend over a long period of years, it was obvious at the outset that responsibility for the management of the Railway Company during the period of reconstruction would rest with the Preferred Stock.

As an inducement to the holders of the Preferred Stock A to support a conservative dividend policy and permit liberal use of surplus earnings to improve and develop the property and strengthen its earning power, the Preferred Stock A was given the right to participate

equally with the Common Stock in the distribution of surplus earnings in excess of 5%. While the Preferred Stock B was not given the right to participate directly in excess surplus earnings, the holders thereof would ultimately acquire an equal participation therein by conversion of their stock into Preferred Stock A and Common Stock. There was, therefore, an equally strong inducement to the Preferred Stock B to support a policy which would develop and strengthen the earning power of the Railway Company.

The two issues of Preferred Stock were made noncumulative so that the Board of Directors in the exercise of the discretion established by this Court's decision in the *Nickals* case might freely use current earnings for improvements and additions to the property and equipment of the Railway Company to enable it adequately to discharge its public duties.

From the record it appears that approximately $16,000,000 was used for these purposes. These appropriations of earnings were made over a period of more than ten years and at no time during this long period does it appear that there was any claim or suggestion that the Board of Directors, instead of building up property of the Railroad Company for the benefit of all stockholders, were in fact building up a huge dividend credit for the benefit of the Preferred Stock A. It is apparent that the creation of such a dividend credit by judicial decree and the marking of invested surplus to satisfy such a credit would undermine the financial structure of the Railway Company, impair the investment of the common stockholders and cause a widespread disturbance of property rights long vested upon the faith of this Court's decision in the *Nickals* case.

The confusion which such a decision would create and the problems which would arise thereunder are incalculable.

To illustrate:

(1) During the years 1916, 1917 and 1918, there were earnings aggregating $15,486,352 out of which Preferred A dividends were declared and paid in the amount of $2,310,000, leaving a balance of $13,176,352. Against this balance, dividend credits are claimed in the amount of $5,283,225, so that if the accounts of the Railway Company were recast to mark a part of this surplus to the credit of Preferred Stock A, $5,283,225 thereof would be so marked, leaving a balance of $7,893,127 of surplus either free or marked for a junior issue. But in the years 1919 and 1920, there were operating deficits aggregating $9,916,778—an amount sufficient entirely to wipe out either the marked surplus or the free surplus and impinge upon the other, and the question at once arises whether such deficits are to be charged wholly against the marked surplus or wholly against the free surplus, or chargeable pro rata against the marked surplus and the free surplus, or whether, once a dividend credit has accrued, it survives all future deficits as a continuing charge against the future prosperity of the Company. (Tr., pp. 40-42)

(2) It appears from the record that in each of the years 1916 to 1925, inclusive, substantial amounts of Preferred Stock A were issued in conversion of Preferred Stock B, the total outstanding shares of Preferred Stock A increasing from 462,000 in 1917 to 693,056⅔ in 1925. Assuming that the issue of these new Preferred A shares was distributed over a twelve months period in each year in which a dividend credit is claimed to have accrued, there are a minimum of 84 dividend credits, each differing in amount, applicable to the stock outstanding in 1925 which would give 84 different values to an issue of stock, the shares of which are listed on the New York Stock Exchange and have always been bought and sold upon the assumption that all shares had the same value. (Tr., pp. 40-42)

A judicial decision construing a contract so as to create such manifest abuse could only be justified by language showing an unmistakable intent.

It is submitted that the Preferred A Stock contract shows a different intent.

III.

An analysis of the authorities relied upon by the respondents fortifies the legal conclusions above expressed.

An exhaustive review of the authorities relied upon by the respondents would be unprofitable. They are reviewed in the opinion of the Circuit Court of Appeals and the dissenting opinion of Circuit Judge Learned Hand. All of them will be found either distinguishable and inapplicable or to fortify the legal conclusions above expressed. The case of *Dent v. London Freehouse Company*, L. R. 16 Ch. Div. 344, may be passed over. This case together with *Boardman v. Lake Shore & Michigan Southern Railway Company*, 84 N. Y. 157, is distinguished by this Court in its opinion in the Pathé case. The cases of *Wood v. Lary*, 47 Hun 100, and *Bard v. Ottawa Gas and Electric Company*, 133 Fed. 967, were based upon contracts under which the Board of Directors had no discretion. The cases arising under the New Jersey statute have already been discussed and have been shown to have no value as authority outside of the State of New Jersey. The case of *Star Publishing Company v. Bird*, 134 N. E. 205, involved a flagrant breach of discretion on the part of the directors and was correctly decided. The facts are important. The Star Publishing Company was an industrial corporation organized under the laws of Indiana, having outstanding non-cumulative preferred stock and common stock. From

1908 to the time of the institution of the suit, the Publishing Company was prosperous and it appears from the opinion of the Supreme Court of Indiana that from 1911 to 1918 the company could have paid on the first days of March, June, September and December, dividends at the rate of 5% per annum on its preferred stock without depleting its cash assets, impairing its solvency, injuring its business or the rights of its shareholders. During this period the Board of Directors withheld payment of dividends upon the preferred stock and the Supreme Court held that as to at least a part of this period, there had been a gross breach of discretion. It accordingly decreed the payment of dividends upon the preferred stock to the extent of $39,050, although the amount of unpaid dividends on the preferred stock was actually $62,125. Notwithstanding the fact that $23,075 of preferred dividends were earned and unpaid, the Court approved the payment of a dividend upon the common stock. It is submitted that this decision under which a dividend was decreed to be paid upon common stock although dividends on the non-cumulative preferred stock were unpaid during a long period in which they were regularly earned, definitely commits the Supreme Court of Indiana—the State of the domicile of Wabash Railway Company—to the traditional conception of non-cumulative preferred stock.

The respondents, in support of their contention rely strongly upon *Collins* v. *Portland Electric Power Company*, 12 Fed. Rep. (2nd Series) 671 (1926).

The certificate for the Second Preferred Stock of the Portland Electric Power Company provided that:

> "The holders of the second preferred stock are entitled to receive, when and as declared, out of the surplus or net profits of the Company, dividends at the rate of 6% per annum, payable as the board of directors may determine, before any dividends shall be set apart for or paid upon the common stock."

The certificate further provided that dividends might be paid upon the common stock, provided that

> "dividends on the second preferred stock at the rate of 6% per annum for a period of 6 months immediately preceding the day on which the common stock dividend shall have been paid in full."

The litigation which included cross-suits by the second preferred stockholders and common stockholders involved dividends for the years 1920, 1921, 1923 and 1924. In every year previous to 1920 the earnings were insufficient to pay dividends on the cumulative preferred stocks prior to the second preferred stock. In 1920 they were sufficient to provide for dividends for that year on these prior stocks but not for arrears of cumulative dividends thereon. In 1921 and 1923 the earnings were sufficient to pay dividends on all prior stocks, including arrears of cumulative dividends thereon, with a balance for the second preferred. Prior to suit brought a dividend of 1½% for 1923 was paid upon the second preferred stock. In 1924 large earnings were made and in March, 1925, additional dividends of ½ of 1% were declared upon the second preferred stock for each of the years 1920, 1921 and 1923 thus making a total of 3 per cent. declared in dividends on the second preferred stock. In April 1925 a common dividend of 10¢ per share was declared for 1924.

The common stockholders asked for an injunction restraining the payment of the dividend on the second preferred stock for 1920, 1921 and 1923 upon the ground that there were no distributable earnings for 1920 and that an unearned non-cumulative preferred dividend could not be fastened upon the profits of future years and that any right to a dividend for each of these three years was lost when the Board failed to make a seasonable declaration.

The preferred stockholders asked for an injunction restraining the payment of the dividend on the common stock for 1924 on two grounds:

FIRST.—That no distribution could be made upon the common stock until all *earned,* but undeclared preferred dividends were liquidated.

SECOND.—That no distribution of 1924 earnings could be made upon the common stock until the whole and not merely a *pro rata* part of the 6% dividend was paid upon the second preferred stock.

The Court held that payment of the dividend on the common stock should be enjoined upon the ground *last* stated; that payment of the 1920 dividend on the second preferred stock should be enjoined because not earned; and that the 1921 and 1923 dividends on the second preferred were not improper because of the belated character of the declaration.

In appraising this decision it is important to bear in mind that a determination of the fundamental contention of the preferred stockholders, namely, that the preferred dividend was a fixed charge upon net earnings, would have disposed of all points in controversy and would have rendered unnecessary (a) the decision that the discretionary power of the Board in the matter of dividends is not lost if not immediately exercised, and (b) the decision that notwithstanding the six months' clause a dividend could not be paid in any year upon the common stock until the full 6% was declared upon the second preferred stock. That the Court based its decision upon the determination of these two latter propositions indicates clearly that the novel theory advanced by the respondents was not accepted by the Court.

The foregoing cases are believed to cover substantially the entire field.

In only two cases, namely, *Wood* v. *Lary* and *Burk* v. *Ottawa Gas and Electric Company,* was the non-cumulative clause given the unusual meaning for which Wabash Preferred A stockholders are now contending, and in each of these cases by explicit terms of the stock contract the obligation of the Company to pay the dividend if earned was fixed and definite and the Board of Directors had no discretion whatever.

In one of the petitions for a writ of certiorari in the present case, the attention of this Court is called to the case of *Missouri Pacific Railroad Company* v. *Texas and Pacific Railway Company and others,* 282 Fed. Rep. 61, (1922). In that case, the Circuit Court of Appeals for the Fifth Circuit, following the decision of this Court in the *Nickals* case, held that income bondholders were not entitled in later years to recover out of accumulated surplus interest for years in which the Board of Directors determined that the current earnings ought to be invested in road and equipment. If an income bondholder must lose his claim to interest when earnings which might have been applied thereto are invested in road and equipment, it is difficult to reconcile such conclusion with the decision of the Circuit Court of Appeals for the Second Circuit in this case, which gives a superior position to non-cumulative Preferred Stock.

IV.

The decision of the Circuit Court of Appeals should be reversed and the case remanded to the Circuit Court of Appeals under a mandate for affirmance of the decree of the District Court.

Respectfully submitted,

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APPENDIX.

Extract from Certificate representing Five per cent. Profit-sharing Preferred Stock A Wabash Railway Company.

"The holders of the Five Per Cent. Profit Sharing Preferred Stock A of the Company shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. before any dividends shall be paid upon any other stock of the Company, but such preferential dividends shall be non-cumulative. The holders of the Five Per Cent. Convertible Preferred Stock B of the Company shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. after payment of the full five per cent. dividend on the Five Per Cent. Profit Sharing Preferred Stock A, but before any dividends shall be paid upon the Common Stock, but such preferential dividends shall be non-cumulative, and the holders of the Five Per Cent. Convertible Preferred Stock B shall not be entitled to any other or further dividends in any fiscal year. After the payment or the setting apart in any one fiscal year of five per cent. dividends upon the Five Per Cent. Convertible Preferred Stock B, and upon the Common Stock, the holders of the Five Per Cent. Profit Sharing Preferred Stock A shall be entitled to receive additional dividends at the same rate per cent. as any further or additional dividends which may be declared in that year upon the Common Stock. The Five Per Cent. Profit Sharing Preferred Stock A shall at the option of the Company, be redeemable as an entirety at any time after December 1, 1920, upon twelve weeks' notice at the price of One Hundred and Ten per cent. of its par value, and the Five Per Cent. Convertible Preferred Stock B, at the option of the Com-

pany, shall be redeemable as an entirety at any time after December 1, 1920, upon like notice and at the same price. The holders of the Five Per Cent. Convertible Preferred Stock B may at any time after August 1, 1918, and up to thirty days prior to any date fixed for the redemption of the entire issue of Five Per Cent. Profit Sharing Preferred Stock A, convert the same into and exchange the same for Five Per Cent. Profit Sharing Preferred Stock A and Common Stock at the rate of Fifty Dollars ($50) par value of Five Per Cent. Profit Sharing Preferred Stock A, and Fifty Dollars ($50) par value of Common Stock for each One Hundred Dollars ($100) par value of Five Per Cent. Convertible Preferred Stock B, with a proper adjustment of declared and unpaid dividends. In the event of any liquidation, dissolution or winding up (whether voluntary or involuntary) of the Company, (1) the holders of the Five Per Cent. Profit Sharing Preferred Stock A shall be entitled to be paid in full out of the assets of the Company the par amount of their stock and all dividends thereon declared and unpaid before any amount shall be paid out of said assets to the holders of any other stock of the Company, (2) the holders of the Five Per Cent. Convertible Preferred Stock B shall then be entitled to be paid in full out of the assets of the Company the par amount of their stock and all dividends thereon declared and unpaid before any amount shall be paid out of said assets to the holders of the Common Stock (3) the holders of the Common Stock shall then be entitled to be paid in full out of the assets of the Company the par amount of their stock and all dividends thereon declared and unpaid, and (4) thereafter the holders of all classes of stock of the Company, without priority or distinction as between the different classes thereof, shall be entitled to participate pro rata in the remaining assets of the Company. Holders of all shares of stock of the Company have equal voting rights share for share alike."

Extract from Certificate of Incorporation of Wabash Railway Company.

"The Five Per Cent. Profit Sharing Preferred Stock A shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. before any dividends shall be paid upon any other stock of this corporation, but such dividends on the Five Per Cent. Profit Sharing Preferred Stock A shall be non-cumulative. After the payment or the setting apart in any one fiscal year of five per cent. dividends upon the Five Per Cent. Convertible Preferred Stock B and upon the Common Stock of this corporation, the Five Per Cent. Profit Sharing Preferred Stock A shall be entitled to receive additional dividends at the same rate per cent. as any further or additional dividends which may be declared in that year upon such Common Stock. The Five Per Cent. Profit Sharing Preferred Stock A shall, at the option of this corporation, be redeemable as an entirety at any time after December 1, 1920, upon twelve weeks' notice, at the price of one hundred and ten per cent. (110%) of its par value. In the event of any liquidation, dissolution or winding up (whether voluntary or involuntary) of this corporation, the holders of the Five Per Cent. Profit Sharing Preferred Stock A shall be entitled to be paid in full, out of the assets of this corporation, the par amount of their stock and all dividends thereon declared and unpaid, before any amount shall be paid out of said assets to the holders of any other stock of this corporation; but after payment in full to the holders of the Five Per Cent. Convertible Preferred Stock B and Common Stock of this corporation of the par amount of their stock and all dividends thereon declared and unpaid, holders of all classes of stock of this corporation, without priority or distinction as between the different classes thereof, shall be en-

titled to participate pro rata in the remaining assets of this corporation.

The Five Per Cent. Convertible Preferred Stock B shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. after payment of the full five per cent. dividends on the Five Per Cent. Profit Sharing Preferred Stock A, but before any dividend shall be paid upon the Common Stock of this corporation. Said dividends shall be non-cumulative, and the Five Per Cent. Convertible Preferred Stock B shall not be entitled to any other or further dividends in any fiscal year. The holders of the Five Per Cent. Convertible Preferred Stock B may, at any time after August 1, 1918, and up to thirty days prior to any date fixed for the redemption of the entire issue of Five Per Cent. Profit Sharing Preferred Stock A, convert the same into, and exchange the same for, Five Per Cent. Profit Sharing Preferred Stock A and Common Stock of this corporation. For the purpose of such conversion this corporation shall have power, from time to time, to issue such amounts of its Five Per Cent. Profit Sharing Preferred Stock A and Common Stock in addition to the amounts hereby specifically authorized as may be necessary. Such conversion shall be at the rate of Fifty Dollars ($50) par value of Five Per Cent. Profit Sharing Preferred Stock A and Fifty Dollars ($50) par value of Common Stock for each One Hundred Dollars ($100) par value of Five Per Cent. Convertible Preferred Stock B, with a proper adjustment of declared and unpaid dividends. The Five Per Cent. Convertible Preferred Stock B shall, at the option of this corporation, be redeemable as an entirety at any time after December 1, 1920, upon twelve weeks' notice, at the price of one hundred and ten (110%) per cent. of its par value. In the event of any liquidation, dissolution or winding up (whether voluntary or involuntary) of this corporation, the holders of the Five Per

Cent. Convertible Preferred Stock B, shall be entitled to be paid in full, out of the assets of this corporation, the par amount of their stock and all dividends thereon declared and unpaid, before any amount shall be paid out of said assets to the holders of the Common Stock; but after payment in full to the holders of the Common Stock of the par amount of their Common Stock and all dividends thereon declared and unpaid, holders of all classes of stock of this corporation, without priority or distinction as between the different classes thereof shall be entitled to participate pro rata in the remaining assets of this corporation."

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. [redacted] 37

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, LaMOTTE COHU, GERALD V. HOLLINS, GEORGE R. LESLIE, EARLE KRAPP and WILLIAM FRASER DICKSON,

Petitioners,

v.

JOHN C. BARCLAY and WILLOUGHBY COMPANY,

Respondents.

BRIEF FOR RESPONDENTS AGAINST PETITION FOR WRIT OF CERTIORARI.

WILLIAM R. BEGG,
ELLIS AMES BALLARD,
JOSEPH S. CLARK,
Counsel for Respondents.

Pandick Press, Inc., 22 Thames St., New York, U. S. A.

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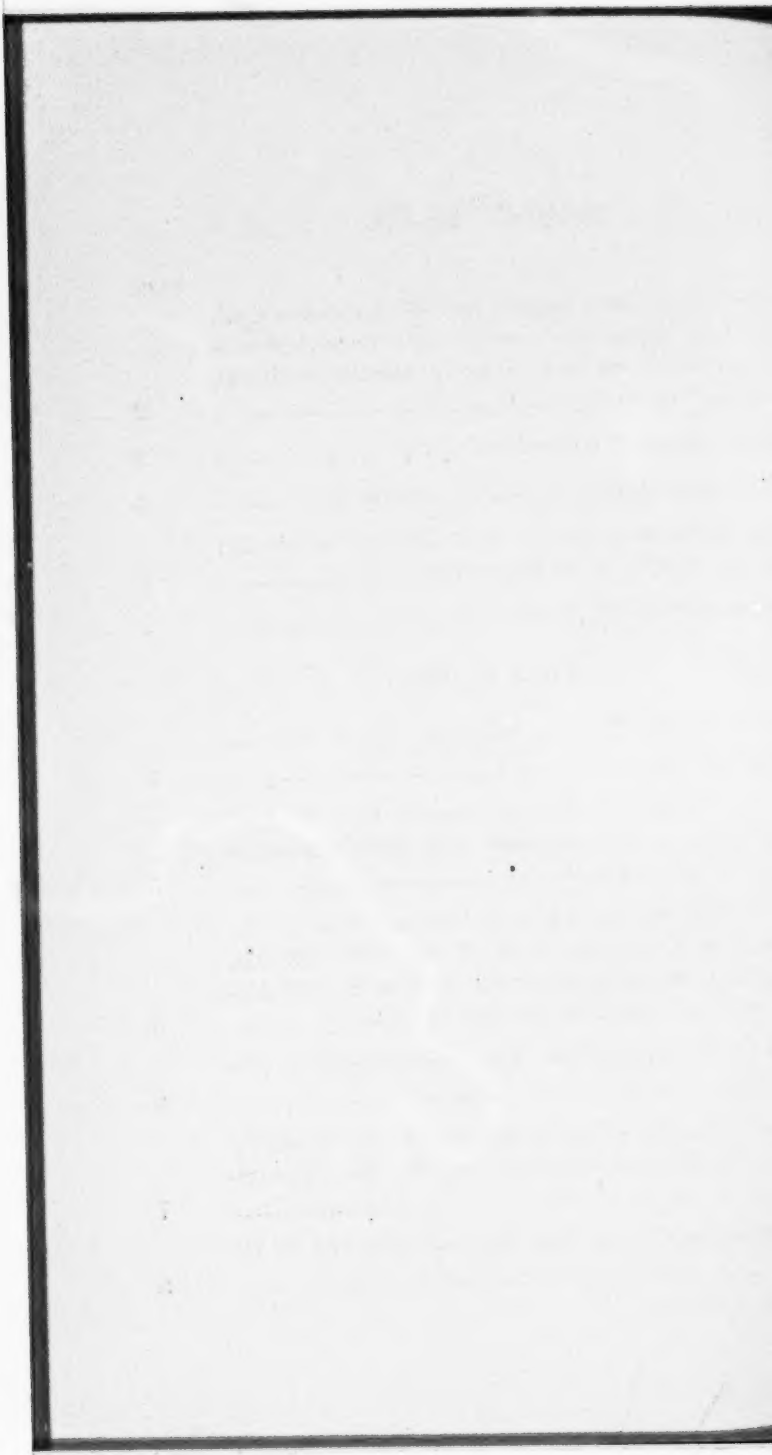

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WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, LAMOTTE COHU, GERALD V. HOLLINS, GEORGE R. LESLIE, EARLE KRAPP and WILLIAM FRASER DICKSON,

Petitioners,

v.

JOHN C. BARCLAY and WILLOUGHBY COMPANY,

Respondents.

BRIEF FOR RESPONDENTS AGAINST PETITION FOR WRIT OF CERTIORARI.

Two petitions for writs of certiorari have been filed in this case, one by the petitioners named above and another by Shirley P. Austin, the owner of common stock of the Railway Company. The basis for the petition filed by Austin is that the decision of the Circuit Court of Appeals is a decision in conflict with the decision of another Circuit Court of Appeals on the same matter. We have answered that point in the brief that we have filed against the writ of certiorari for which said Austin prays. The basis for the petition filed by the petitioners named above is the following question:

Is the Decision of the Circuit Court of Appeals a Decision of an Important Question of General Law in a Way Probably Untenable or in Conflict with the Weight of Authority?

This question divides itself into the following three points:

1. What was the question decided?

2. Was it an important question of general law?

3. Was the decision probably untenable or in conflict with the weight of authority?

We will consider these three points in their order.

What Was the Question Decided?

The question decided is very clearly set forth in the last paragraph of the opinion of the Circuit Court of Appeals (Record, p. 117). It called for the proper interpretation of the following charter provision of the Wabash Railway Company (Record, fols. 39-40):

> "The 5% profit-sharing Preferred Stock A shall be entitled to receive preferential dividends in each fiscal year up to the amount of 5% before any dividends shall be paid upon any other stock of this corporation, but such dividends on the 5% profit-sharing Preferred Stock A shall be non-cumulative." *

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* This provision is quoted on pages 2-3 of the Petition, but there is a clerical error in the third line of the third page, the word "the" being substituted for the word "any", making the clause read "upon *the* other stock of the Company" instead of "upon *any* other stock of the Company".

This charter provision expresses two points: (a) the amount of the preferential dividend the A stock is entitled to receive in each year and (b) the preference in payment given to said dividends. The amount of the dividend for each year is determined by the phrase "up to the amount of 5%" but this phrase does not definitely state the amount. It may be 5% or it may be less. The word "non-cumulative" fills in the gap. That word when used to define preferred dividends means "dependent upon the earnings of each particular year". This was decided as long ago as 1886 in the case of *New York, Lake Erie & Western R. R. Co.* vs. *Nickals*, 119 U. S. 296, in which the Court said, in speaking of non-cumulative dividends:

> "non-cumulative because dependent upon the earnings of each particular year."

We do not believe that petitioners will deny that the word "non-cumulative" when used in this connection has this meaning. They argue that it has a further meaning, which is, that a non-cumulative preferred dividend for a particular year, although earned in that year, if not paid out of the earnings of the year, cannot be charged against the earnings of any subsequent year. It is true that if a non-cumulative preferred dividend for a particular year is not earned in that year, there is a deficiency of earnings to cover the year's dividend and that deficiency cannot be charged against the earnings of any subsequent year. That deficiency is lost to the stockholders. This is the difference between a cumulative and a non-cumulative dividend. If the dividend is cumulative the deficiency is chargeable against subsequent earnings.

This question is interesting and the difference is well established by the authorities. The point, however, is not

involved in the present case. The Circuit Court of Appeals said nothing about any charge or preference in favor of the A dividends upon subsequent earnings or any other moneys of the company. It held that the preferred dividend credit must be liquidated before any junior dividends could be paid, without any reference to the funds which might be appropriated to accomplish such liquidation.

It will be appreciated that this point relates to the preference given to the A dividends, for the question is whether earned but unpaid A dividends for prior years are entitled to a preference in payment over junior dividends. The preference given to the A dividends is defined in the charter provision by the words "preferential dividends" and the further statement that the Preferred A stock is entitled to receive its dividends "before *any* dividends shall be paid upon any other stock of the Company." Upon this question of preference the Circuit Court of Appeals held that the word "non-cumulative" had no bearing. There is nothing to indicate that the dissenting Judge differed with the majority of the Court on this point.

The foregoing discussion shows the nature of the question which was decided by the Circuit Court of Appeals and which is clearly set forth in the last paragraph of its opinion (Record, p. 117).

Was It an Important Question of General Law?

In all contracts of this kind the preference depends upon the provisions of the contract which define it. We deny that the word "non-cumulative" has any influence in determining the extent of the preference. That word has no influence except to determine the *amount* of the dividend which the A stock is entitled to receive. If on this point

we are in error and petitioners are right, it follows that in the interpretation of each contract of this kind the word must be read in connection with the other language of the contract which defines the preference. The question therefore becomes a question of the proper interpretation of each particular contract rather than "an important question of general law". This was the view taken by the Judge who filed the dissenting opinion in the Circuit Court of Appeals. He based his dissent upon a few words in the contract which he quoted at the beginning of his opinion (Record, p. 118). He did not consider the word "non-cumulative" of any importance, for he did not mention it at any point in his opinion.

Was the Decision Probably Untenable or in Conflict With the Weight of Authority?

This decision was the natural result of giving the word "non-cumulative" the same meaning which was given to it by this Court in the Nickals case in 1886 and in numerous decisions cited and discussed in the opinion of the Circuit Court of Appeals in support of its conclusion (Record, pp. 103-117). The same and other cases were cited and discussed in the opinion of the Circuit Court of Appeals for the Ninth Circuit in the case of *Collins* vs. *Portland Electric Power Co.*, 12 Fed. (2nd) 670, and in the opinion of Wolverton, D. J., in the same case, reported in 7 Fed. (2nd) 221, and both courts reached the same conclusion.

Particular attention is called to the Cast Iron Pipe and Foundry cases in New Jersey, which are fully discussed in the above opinions. Petitioners in their brief (p. 20) dispose of these cases by saying that they arose under a New Jersey statute which abridged the ordinary directorial dis-

cretion. The statute did not affect the decisions in so far as they defined the meaning of the word "non-cumulative". One of these cases, entitled *Day* vs. *U. S. Cast Iron Pipe and Foundry Co.*, is spoken of in the dissenting opinion (Record, p. 119), and the statement is there made that it was decided by an evenly divided Court. The Court evidently divided, not upon the interpretation of the word "non-cumulative", but upon another provision of the contract which authorized payment of common dividends. There is no such provision in the Wabash contract.

In the present case we are not contending that the ordinary directorial discretion of the Board has been abridged. The Board has full authority to appropriate the earnings of any year for any proper corporate purpose. When, however, the Board determines to pay dividends, the contract defining the dividend rights of the several classes of stockholders controls and determines which class of stockholders is entitled to receive the dividend.

Notwithstanding all of these decisions petitioners contend that the decision of the Circuit Court of Appeals is a decision of an important question of general law in a way probably untenable or in conflict with the weight of authority. In support of this contention they cite the following two decisions of this Court: *New York, Lake Erie & Western R. R. Co.* vs. *Nickals*, 119 U. S. 296 (1886), and *Continental Insurance Co.* vs. *United States*, 259 U. S. 156 (1922).

In the Nickals case preferred stockholders whose dividends were designated "non-cumulative" brought suit to force the Company to pay their dividends which had been earned in a prior year. It appeared that the Board had appropriated the earnings of that year to pay for much needed extensions and improvements. The contract provided that the dividends should be payable "as declared by

the Board". The Court held that the Board was vested with a proper discretion to appropriate the earnings for the purposes indicated and dismissed the bill. If in the present case the A stockholders were demanding payment of their earned dividends for prior years, the Nickals case would be in point. They are not demanding payment, but are asking for an injunction to prevent the payment of junior dividends until their dividend credit is liquidated. The preferential right of the preferred to receive dividends before common dividends could be paid was not presented in the Nickals case. The Court, however, in the course of its discussion said that the preferred stockholders were entitled to their dividends "in advance of the common stockholders". The fact that the dividends were non-cumulative had nothing to do with the conclusion. It would have been the same if the dividends had been cumulative. The Court defined the word by stating "non-cumulative because dependent on the profits of each particular year".

In *Continental Insurance Co.* vs. *United States, supra,* it appeared that the Company had issued non-cumulative preferred and common stocks, but the dividend rights of the preferred were not involved. The point decided was that earnings made over a long period of years, which prior to dissolution might have been used to pay common dividends, must upon dissolution be considered as capitalized and distributed as capital. The meaning of the word "non-cumulative" was not discussed or involved. In the present case there has been no capitalization of the earnings of prior years, which might have been paid as Preferred A dividends instead of being appropriated to increase the working capital, or to pay the cost of extensions and additions. On this point see the very recent case of *People of Colorado ex rel. Fraser* vs. *Great Western Sugar Co.,* in

the Circuit Court of Appeals for the Eighth Circuit, decided December 1, 1928, 29 Fed. (2nd) 810, Advance Sheets of February 14, 1929.

Petitioners also cite the case of *Star Publishing Co.* vs. *Ball*, 192 Ind. 158, 104 N. E. 283, and argue that the decision is in conflict with the decision of the Circuit Court of Appeals in the present case. In that case preferred stockholders whose dividends were non-cumulative demanded payment of dividends which had been earned in prior years, but still remained unpaid. They amounted to $62,125, but the Court ordered payment of $39,050 only, leaving the balance, to-wit: $23,075 unpaid and explained that fact by stating that the record failed to show the amount required for working capital and therefore it did not reverse the Trial Court and order payment of this balance. It expressly held, however, that failure to pay an earned non-cumulative preferred dividend for prior years and the appropriation of the earnings of that year for other proper corporate purposes operates as a suspension only of the right of the preferred stockholders to receive those dividends. This case is fully discussed in the opinion of the Circuit Court of Appeals and also in the opinion in the Portland case. Petitioners call attention to the fact that although the Court failed to order payment of this balance of earned but unpaid dividends for prior years, it approved payment of a participating dividend to the preferred and common stockholders and therefore approved payment of common dividends before all of the earned but unpaid preferred dividends for prior years were paid and satisfied. It appeared that this participating dividend had been ordered by the Trial Court and evidently no assignment of error on that point had been filed by the preferred stockholders, for the point was not discussed by the appellate

court and was mentioned incidentally only. It further appeared that the bill did not ask for an injunction to restrain the payment of common dividends and, in addition, that the question whether the preference given the preferred dividends was a preference upon the earnings of subsequent years was not mentioned.

Petitioners' point that the decision of the Circuit Court of Appeals is probably untenable or in conflict with the weight of authority cannot be sustained. .

Other Non-cumulative Stocks.

Petitioners cite a long list of non-cumulative preferred stocks which they say may be affected by the decision of the Circuit Court of Appeals (Petition, p. 4). They state that the fact that so many non-cumulative preferred stocks are outstanding indicates the great importance of the question presented and the wide-spread interest in it. Although this may be true, that fact does not indicate that the decision of the Court of Appeals is "probably untenable or in conflict with the weight of authority". It may be that petitioners' reason for citing this list of non-cumulative preferred stocks was that at one time there was propounded in certain financial circles a theory that a non-cumulative preferred dividend for a particular year, if not declared within the year, is lost to the stockholders; that the declaration and payment of any such dividend is a matter of discretion with the Board, and that if such declaration and payment should be postponed beyond the end of the year all right to the dividend for that year is gone. We believe it is true that a theory of that kind was discussed, but it is now an exploded theory. It is not even presented by petitioners.

Petitioners, however, do present a corollary to that theory, which is that the only fund out of which a non-cumulative preferred dividend for a particular year may be paid is the earnings of that year and if those earnings are appropriated by the Board for other proper corporate purposes, such as payment for constructions of extensions and improvements, nothing is left for the stockholders for that year's dividend unless it be a frozen credit which may never be liquidated by the Company. Neither this theory nor its corollary has ever had any support in the authorities.

There is no reason to believe that the holders of these other preferred stocks are not and were not advised of the true meaning of the word "non-cumulative" when used to define preferred dividends. The interpretation placed upon that word by the Circuit Court of Appeals is not a new interpretation.

In petitioners' discussion of these other preferred stocks (Petition, pp. 6-7) the statement is made that the two Judges of the Circuit Court of Appeals who concurred in the decision are on one side of the issue and the dissenting Judge and the District Judge are on the other side. The dissenting Judge did not disagree with the other two Judges of the Circuit Court of Appeals upon the proper meaning of the word "non-cumulative". He said at the beginning of his opinion (Record, p. 118) "The relevant clause of the charter gives the plaintiffs preferred* dividends in each fiscal year up to the amount of 5%". He held that the words quoted from the contract are words of limitation as well as grant and that the preference given the

* In this quotation which appears on page 118 of the Record the word "preferred" was inadvertently substituted for "preferential". The meaning is of course the same.

A dividend for each year is a preference upon the earnings of that year only. He does not undertake to define the meaning of the word "non-cumulative". That word is not mentioned at any point in his opinion. On the main issue, therefore, we have the two Judges who concurred in the opinion of the Circuit Court of Appeals on the one side and Winslow, D. J., on the other. Why should we leave out the Judges who decided the Portland case in the Ninth Circuit? All three Judges in the Circuit Court of Appeals concurred in affirming the decision of Wolverton, D. J. We have therefore these four Judges to add to the two who concurred in the opinion of the Circuit Court of Appeals in the present case, and the figures therefore show six in favor of respondents against one only, that is, Winslow, D. J., in favor of petitioners.

In conclusion respondents rely with confidence upon the full and careful opinion filed by the Circuit Court of Appeals and we respectfully submit that the petition should be denied.

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Joseph S. Clark,
Counsel for Respondents.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. [redacted]38

SHIRLEY P. AUSTIN,
Petitioner,

vs.

JOHN C. BARCLAY and WILLOUGHBY CO.,
Respondents.

BRIEF FOR RESPONDENTS AGAINST PETITION FOR WRIT OF CERTIORARI.

WILLIAM R. BEGG,
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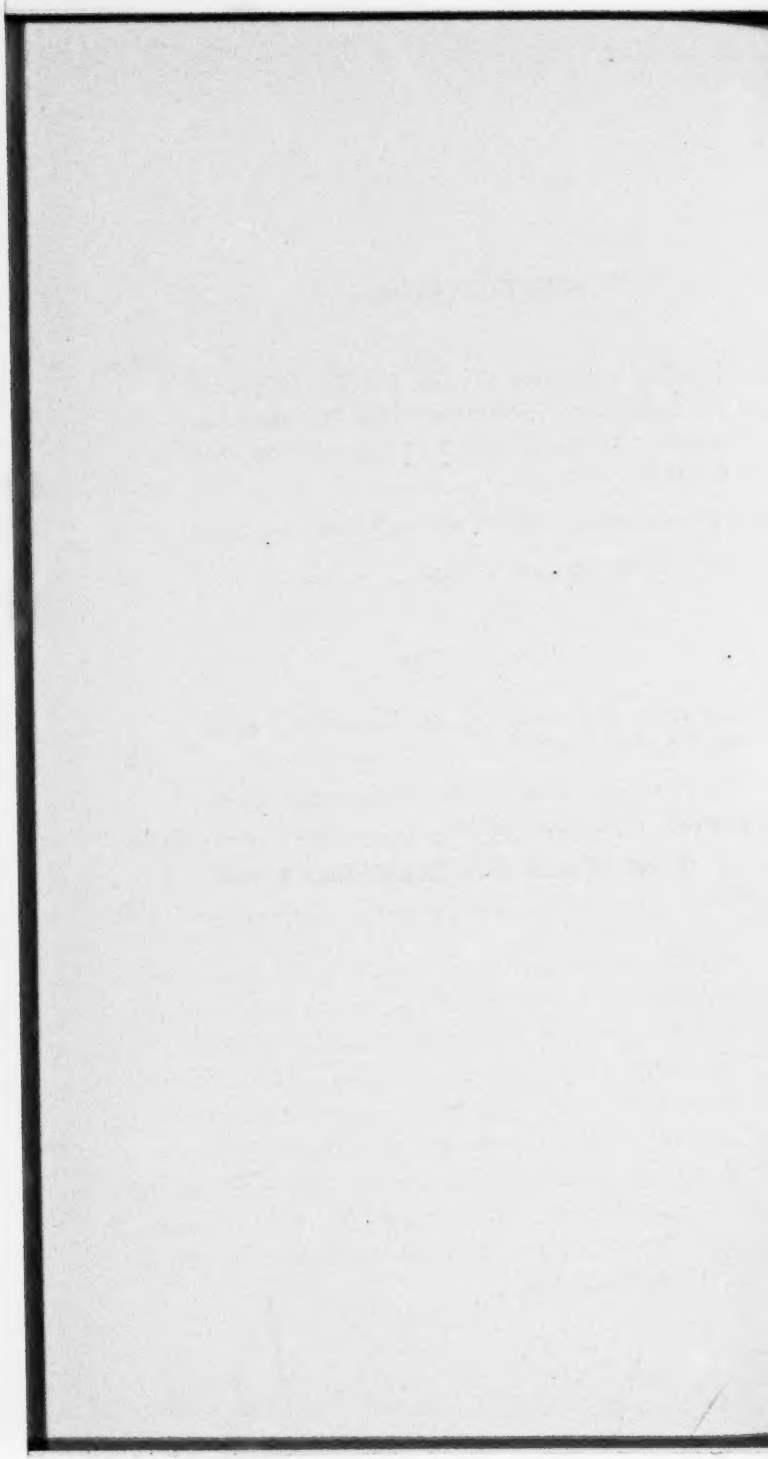

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SHIRLEY P. AUSTIN,
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Respondents.

BRIEF FOR RESPONDENTS AGAINST PETITION FOR WRIT OF CERTIORARI.

Two petitions for writs of certiorari have been filed in this case, one by the petitioner named above and another by Wabash Railway Company, *et al.* The basis for the petition filed by the Railway Company, *et al.*, is that the decision of the Circuit Court of Appeals was a decision of an important question of general law in a way probably untenable or in conflict with the weight of authority. We have answered that point in the brief that we have filed against the writ of certiorari for which said Railway Company, *et al.*, pray. The basis for the petition filed by Shirley P. Austin is the following point:

IS THE DECISION RENDERED BY THE CIRCUIT COURT OF APPEALS A DECISION IN CONFLICT WITH THE DECISION OF ANOTHER CIRCUIT COURT OF APPEALS ON THE SAME MATTER?

In the brief submitted in support of the petition filed by Shirley P. Austin the case of *Missouri Pacific Raliroad Co.* vs. *Texas & Pacific Railway Co.*, 282 Fed. 61, decided by the Circuit Court of Appeals for the Fifth Circuit is cited and it is argued that the decision of the Circuit Court of Appeals in the present case is in conflict with said decision of the Circuit Court of Appeals for the Fifth Circuit, which settled the rights of income bondholders to non-cumulative interest for prior years. The fact that the interest was designated non-cumulative was not considered of any importance. The word "non-cumulative" was mentioned incidentally only. The decision was rested upon the peculiar language of the contract, coupled with the long continued practical construction of that language. That decision in the Fifth Circuit is therefore not in conflict with the decision of the Circuit Court of Appeals in the present case. There is a decision on the same matter in the Circuit Court of Appeals for the Ninth Circuit. It is the case of *Collins* vs. *Portland Electric Power Company* and *Kurtz* vs. *Same,* 12 Fed. (2nd) 671, affirming the decision of Wolverton, D. J., reported in 7 Fed. (2nd) 221. The only comment made upon that case by petitioners (see their brief, p. 20) is that it is inconclusive and does not touch the fundamental question decided by the Circuit Court of Appeals. We are not in accord with that view. We submit that the opinions in the Portland case contain a full and accurate discussion of the questions decided by the Circuit Court of Appeals in the present case and it was expressly

decided that the preferred stockholders, whose dividends were non-cumulative, were entitled to enjoin the payment of common dividends until after all of the earned dividends for prior years were first paid and satisfied.

Reasons Presented for Review Not Sufficient.

Petitioner sets forth various reasons for the review by this Court of the decision of the Circuit Court of Appeals. The public interest and the disturbance of vested property rights and the accounting problems and the destruction of stock exchange markets for non-cumulative preferred stocks are much exaggerated. It is fair to assume that the dividend credit in favor of the Preferred A stockholders, which was approved by the Circuit Court of Appeals, was a credit for the benefit of all of the preferred stock, including that which has been issued since the credit was created. If no such additional stock had been issued this point could not be made. There is no reason to doubt that full justice will be done to all of the Preferred A stockholders if this petition is denied, but if we admit that these points are important, that fact does not call for a review of the case by this Court. It must, in addition, be shown that there is a conflict between the decision of the Circuit Court of Appeals in the present case and the decision of some other Circuit Court of Appeals on the same matter or that the case qualifies under some other class defined in Rule 38, Section 5.

Important Reason Against Review.

A more important argument in favor of the decision of the Circuit Court of Appeals is that, if that decision should be reversed, directors, if owning more common stock than

preferred, will be in a position to postpone payment of preferred dividends and appropriate the earnings to pay the cost of additions and improvements and to increase the working capital and, when the earnings are very materially increased thereby, to declare dividends out of current earnings, giving to the preferred only its current preferential dividends and to the junior stocks increased and increasing dividends, while for its back dividends the preferred must rest satisfied with a frozen credit, secured only upon the increased working capital and the ties, rails and terminal facilities acquired through the appropriation of earnings for such purposes, which the Board might have used to pay preferred dividends. An interpretation of a contract which leads to such conclusions will not be accepted by a court of equity if any other reasonable interpretation can be suggested. *Henry* vs. *Great Northern Railroad Co.*, 1 deG. & J. 606.

We respectfully submit that the petition should be denied.

WILLIAM R. BEGG,
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JOSEPH S. CLARK,
Counsel for Respondents

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Supreme Court of the United States

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Nos. 37-38.

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, *et al.*,
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Respondents.

SHIRLEY P. AUSTIN,
Petitioner,

vs.

JOHN C. BARCLAY and WILLOUGHBY COMPANY,
Respondents.

BRIEF ON BEHALF OF RESPONDENTS.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1929.

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, *et al.*, Petitioners, *vs.* JOHN C. BARCLAY and WILLOUGHBY COMPANY, Respondents.	No. 37
SHIRLEY P. AUSTIN, Petitioner, *vs.* JOHN C. BARCLAY and WILLOUGHBY COMPANY, Respondents.	No. 38

BRIEF FOR RESPONDENTS.

Statement.

We accept statement of the underlying facts set forth in petitioners' brief, pages 4 to 8, except only in two particulars, which are as follows:

1. In the middle of page 5 the preferential dividend right given to the Preferred Stock A by the charter is para-

phrased and the language is not exactly the same as the language of the contract. The exact language is important; and

2. In the sixth line of page 6 the word "dividend" appears. In the contract the word is "dividends", that is, the plural instead of the singular.

The rights of the parties depend upon the proper interpretation of the charter provision or contract which defines the dividend rights of the Preferred A Stock. This contract is set forth at the beginning of Article 4th of the Certificate of Incorporation of the Railway Company (Transcript, p. 10) and reads:

> "The Five Per Cent. Profit-Sharing Preferred Stock A shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. before any dividends shall be paid upon any other stock of this corporation, but such dividends on the Five Per Cent. Profit-Sharing Preferred Stock A shall be non-cumulative."

The Petitioners and the Respondents differ in regard to the proper meaning of the word "non-cumulative", which is the last word in the above quotation, and also the proper meaning of the other language of the quotation.

ARGUMENT.

The primary purpose of the provision quoted above is to vest in the Preferred Stock A the right to receive preferential dividends in each year up to the specified amount, payable before any junior dividends shall be paid. Respondents are of the opinion that the only particular difficulty that arises in the interpretation of the provision is to determine the meaning of the word "non-cumulative".

Wherever in the quotations hereinafter inserted any words are italicized the italics are ours unless otherwise stated.

I.

What is the meaning of the word "non-cumulative" when used to define preferred dividends?

This word defines the amount of the dividend which the preferred stockholders are entitled to receive in and for each year. That amount is dependent upon the earnings of the year. The difference between cumulative and non-cumulative preferred dividends has been the subject of inquiry and discussion in a great many text books and cases. The point of difference relates to the right of the stockholders to receive dividends for any year in which the Company has failed to earn said dividends either in whole or in part. Cumulative preferred dividends must be paid before junior dividends, regardless of the year in which they are earned. This is not true of non-cumulative preferred dividends. If they are not earned in any year, or to the extent that they are not earned in any year, the stock-

holders are not entitled to receive dividends for that year. The deficiency cannot be made up out of the surplus earnings of any subsequent year. Non-cumulative preferred dividends, however, to the extent that they are earned year by year, must be paid before junior dividends are paid.

This difference between cumulative and non-cumulative dividends is well settled by the authorities.

In *Machen on Corporations,* 1908 Edition, Section 551, the author says:

> "Section 551. *Whether Preference is Cumulative.* The first question usually raised as to the preferential dividend is whether the preference is cumulative or not. That is to say, when preferred shares carry a preferential dividend of a certain rate per cent. *per annum,* are they entitled to claim that if the profits of one year are not sufficient to pay that dividend in full, the deficiency must be made good out of the profits of the next or some succeeding year before anything can be paid to the holders of the common shares? If so, the preferred shares are said to be cumulative preferred shares; if not, they are said to be non-cumulative."

The point of difference between cumulative and non-cumulative dividends relates to the right of the stockholders to receive dividends for any year to the extent that they are not earned in that year. The unearned part represents the deficiency. If the dividend is cumulative that deficiency must be made good out of the earnings of subsequent years before junior dividends are paid. The difference relates to the status of the deficiency as distinguished from the status of the earned part of the dividend. If the dividend for any year is earned in that year and there is no deficiency it makes no difference whether the divi-

dends are cumulative or non-cumulative. The amount of a non-cumulative preferred dividend for any year which the stockholders are entitled to receive is the amount earned on account of that dividend in that year.

In *Palmer's Company Precedents*, Part I., 1912, 11th Ed., the author says on page 812:

> "The term 'cumulative preferential dividend' means a dividend payable out of the profits generally in priority to the subordinate class or classes of shares, so that if the profits of one year are not sufficient to pay the dividend for that year, the deficiency accumulates as against subsequent profits, and has to be cleared off before any dividend can be paid on the subordinate class or classes. On the other hand, a non-cumulative preferential dividend means a dividend payable as regards each year out of the profits of that particular year only in priority to the subordinate class, so that if the profits of the year are insufficient, the deficiency is extinguished instead of being carried forward as against subsequent profits."

Note that the deficiency accumulates if the dividend is cumulative, but that the deficiency is extinguished if the dividend is non-cumulative.

In *Palgrave's Dictionary of Political Economy*, Vol. I., (1894), under the heading "Dividend on Stock and Shares", pp. 606-607, we find the following:

> "It is generally stated in the articles whether preference shares are to be cumulative—that is to say, whether a deficiency in dividend arising from insufficiency of profits in one year is to be made good out of profits of subsequent years, or whether preferential dividends are to be paid out of the profits of each year only—non-cumulative dividend."

That deficiency is again mentioned showing that the difference between "cumulative" and "non-cumulative" relates to the status of the deficiency.

In *Clark and Marshall on Corporations,* Section 529-d, we find the following:

> "Sometimes the dividends upon preferred stock are in express terms made to depend upon the profits of each particular year, so that the holders of the stock will not be entitled to any dividends in a particular year if there are not enough profits in that year to pay the same, or will be entitled only in so far as there are profits. In such a case the dividends are not cumulative, and are not to be made up out of the profits, although sufficient, of subsequent years."

In *Staples* vs. *Eastman Photographic Materials Co.*, 65 L. J. Ch. N. S. 682 (1896), L. R. 2 Ch. Div. 303, the Court said:

> "HELD (reversing the decision of Chitty, J.) that the preference shareholders were not entitled to a cumulative dividend of 10 pounds per cent so as to have the deficiency in one year paid out of the profits of a subsequent year before paying anything to the ordinary shareholders."

Note again the use of the word "deficiency."

The preferred dividend was not designated "non-cumulative," but it was made payable "out of the net earnings of each year". The case was discussed in Palmer's Company Precedents, page 813 and at that point the author said:

> "See Staples *vs.* Eastman &c. Co. (1896) 2 Ch. 303, in which case a dividend was held to be non-cumulative although the wording of the clause was ambiguous."

In *Day* vs. *United States Cast Iron Pipe & Foundry Co.* in the New Jersey Chancery Court, 95 N. J. Eq. 389, 123 Atl. 546 (1924), affirmed by the Court of Errors and Appeals by a divided court, 96 N. J. Eq. 736, 126 Atl. 302 (1924), the Vice Chancellor, in considering the discretionary power of the directors to declare dividends, said:

> "They are at liberty to pass dividends year after year and pile up profits, if in their opinion it is for the welfare of the company that this be done—as was done here—and in the absence of fraud, actual or constructive, their judgment is controlling. But once having decided to divide the profits, duty supplants discretion, and it becomes incumbent upon the directors to discharge the company's obligation to pay the fixed yearly dividends, and this before any dividend shall be set apart or paid on the common stock, viz.: To holders of cumulative dividend shares, all arrearages; to holders of non-cumulative dividend stock, the dividends withheld. Otherwise, if the action of the defendant company were sanctioned, and the directors pursued the course they have outlined, the rights of the preferred stockholders in the reserve profits could be indefinitely ignored and altogether subordinated to those of the common stock. Although each class has a definite sum in the reserve and one cannot encroach on the other's for dividends, the preferential right of payment of dividends assured by the statute cannot be disregarded. The statutory design was to meet just such a situation as here confronts the preferred stockholders. The legislative scheme was to protect them in their priority rights to dividends over the common stock in all events, and where, as here, profits of past years applicable to dividends on both preferred and common stock are held in reserve, or there are current profits applicable to dividends on

common stock, it was conceived that this protection would be afforded for forbidding the payment of any dividends on the common stock until the amount due the preferred stockholders was first paid. The statute in this respect is nothing more or less than a definition of the equitable rights of the preferred stockholder arising out of the company's obligation to pay the yearly fixed dividend, for if the company had profits not needed in its business, and was about to distribute them among the common stockholders when it owed dividends on the preferred stock, a court of equity would enjoin the diversion, just as it would intervene in behalf of creditors of a corporation when dividends are in derogation of their rights."

In the Court of Errors and Appeals Judge White said:

"* * * in the absence of refining differences of designation and preferences, and restrictions and qualifications thereof, preferred stock, so far as the payment of dividends is concerned, may, speaking generally, be said to embrace cumulative preferred stock and non-cumulative preferred stock, the distinction between the two being that, while dividends (not in liquidation) upon each can, of course, only be paid out of profits or surplus (*McGregor* v. *Home Ins. Co.*, 33 N. J. Eq. 181; *Mills* v. *Hendershot*, 70 N. J. Eq. 258; 62 Atl. 542); the dividends upon cumulative preferred stock have at all times and for all years past and present, until paid, priority in payment over any and all unpaid dividends upon common stock, whether the net earnings for any particular past or present year were or were not sufficient to pay the stipulated cumulative dividends upon preferred stock for that year; whereas the like priority of dividends upon non-cumulative preferred stock (wholly or partially, as the case may be) is limited

> to the unpaid dividends for those years when such net earnings were sufficient (wholly or in corresponding part) to pay such dividends. This distinction renders it self-evident that the suggestion made by counsel that complainant is contending for cumulative preferred stock rights for his non-cumulative preferred stock, is without merit."

Petitioners undertake to distinguish the Cast Iron Pipe and Foundry Company cases in the New Jersey Courts on the ground that these decisions were influenced by two New Jersey statutes. We are not in accord with that view. In the above quotation from the decision of the Vice-Chancellor in the *Day* case, note the statement near the end that the statute "is nothing more or less than a definition of the equitable rights of the preferred stockholders". In the absence of a statute, the result in a Court of Equity will be the same. Note also the statement in the early part of the decision of Judge White in which "speaking generally" he defines the difference between cumulative and non-cumulative preferred stock. The interpretation placed by these two courts upon the word "non-cumulative" when used to define preferred dividends was not influenced by the provisions of any statute.

In *New York, Lake Erie & Western R. R. Co.* vs. *Nickals*, 119 U. S. 296, 30 L. Ed. 363 (1886), the word "non-cumulative" was defined as follows:

> "non-cumulative because 'dependent on the profits of each particular year', and not to be fastened on the profits of succeeding years."

In *Dent* vs. *London Tramways Co.*, L. R. 16 Ch. Div. 344 (1880), Sir George Jessel gives a very good illustration of the meaning of a preferred dividend which is dependent

upon the earnings of the year. The contract considered provided that the dividends should be

> "dependent upon the profits of the particular year only."

This means that the preferred dividends were non-cumulative. The Court, speaking through Sir George Jessel, M. R., said after quoting these words:

> "That means this, that the preference shareholders only take a dividend if there are profits for that year sufficient to pay their dividend. If there are no profits for that year sufficient to pay their dividend, they do not get it; they lose it forever; and if there are no profits in one year, and 12% profit the next year, they only get 6%, and the other 6% goes to the ordinary shareholders. So that they are, so to say, co-adventurers for each particular year, and can only look to the profits of that year."

See also:

Belfast & M. L. R. Co. vs. *Belfast,* 77 Maine 445; 1 Atl. 362, and again same case, 79 Maine, 411, 10 Atl. 328;

Fletcher's Cyc. of Corporations (1919), Vol. 6, Sec. 3754;

Berle, Studies in the Law of Corporation Finance, Chapter V.;

Three law review articles on non-cumulative dividends, one in 23 Columbia Law Review, page 358 (1923); a second in 11 Va. Law Review, page 553 (1925), and the third in University of Pennsylvania Law Review, Vol. 74, page 605 (1926).

On this branch of the case we submit the following conclusions:

1. All dividends are dependent upon earnings.

2. Cumulative dividends are not dependent upon the earnings of any particular year. If there is a deficiency in any year the full dividend for the year, notwithstanding the deficiency, accumulates with and will be made up out of the earnings of subsequent years. Dividend credit for that year, to the extent of the full specified dividend, is given to the stockholders and the aggregate of the dividend credits for all of the years must be first paid and satisfied before any junior dividends may be paid.

3. A non-cumulative dividend is dependent upon the earnings of each year. If not earned in any year in whole or in part the deficiency cannot be accumulated with and made up out of subsequent earnings. The stockholders are entitled to a dividend credit for that year to the extent only that it is earned within the year.

Petitioners, as we understand their position, agree to points 1 and 2, but not to point 3. They contend that the Board in the absence of an abuse of discretion (and no such abuse is claimed in the present case) has a large measure of control over non-cumulative dividend rights and preferences. They claim:

> (a) That non-cumulative dividend rights depend on dividend declarations and that an inchoate and unenforceable dividend right only is created by the contract.
>
> (b) A non-cumulative dividend for a particular year, even though earned in that year, is lost to the stockholders unless the dividend is declared within the year.

(c) Even though a non-cumulative dividend may have been earned in a prior year and may still remain unpaid, the Board has the right to pay dividends out of the earnings of a subsequent year to the several classes of stockholders, including the Preferred B and the common, in the order of their respective priorities.

We do not agree to any one of these three points. A non-cumulative preferred dividend for any year to the extent that it is earned in that year is no more inchoate and unenforceable than a cumulative dividend. A non-cumulative preferred dividend to the extent that it is earned in a particular year is not lost if not declared within the year, but forms the basis for a dividend credit to the extent that it is earned. No junior dividends may be paid out of the earnings of the subsequent year or the general surplus or any other fund until after the Preferred A dividend credit is first satisfied.

In so far as Petitioners' claims (a), (b) and (c) are based upon the use of the word "non-cumulative", it should be noted that there is nothing in any of the authorities cited above which sustains that view. Petitioners do not discuss or even mention these authorities. They agree, we assume, that preferred stockholders whose dividends are non-cumulative are not entitled to receive more in dividends in and for any year than the amount earned on their stock in that year.

Both Petitioners and Respondents rely for their respective positions, not only upon the word "non-cumulative", but also upon the particular language of the charter provision other than the word "non-cumulative". It is therefore necessary to examine that language.

II.

Analysis of the language of the contract other than the word "non-cumulative".

The contract is quoted above at the beginning of the argument. It grants to the Preferred A stockholders the right to receive preferential dividends in each year up to the specified amount before any junior dividends are paid. It says nothing whatever about the distribution of the earnings of any particular year, prior, present or subsequent. It grants to the A stockholders a priority in payment of their dividends over junior dividends to the extent of the dividends which the Preferred A stock is entitled to receive.

On page 35 of the Petitioners' brief the contract is analyzed in several items (a) to (i) inclusive. We admit the statements made in that analysis. On page 36 of their brief Petitioners comment upon these several items. We comment upon them as follows:

(a) The Preferred A dividend is "preferential" but not guaranteed or made a charge upon any earnings, any more than a cumulative dividend is made a charge on earnings.

(b) Each fiscal year is a separate accounting period to determine the amount of the non-cumulative dividends which the Preferred A stockholders are entitled to receive in and for that year, but not for any other purpose.

(c) The preference is not limited to dividends which may be declared by the Board in the exercise of its ordinary discretion. The dividend right is given by the contract, not by any dividend declaration. The contract provides that the Preferred A stock

"is entitled to receive preferential dividends in each year".

This is vitally different from a contract providing that the Preferred A stock is entitled *to a preference in the payment of dividends in each year.* Under such a contract the preference might not be called into existence until the dividends were declared.

(d) The quotation from *Black* (Petitioners' brief, p. 29) may be correct when applied to a grant of *preference in payment* of non-cumulative dividends, but, when applied to the Wabash contract the statement that the preferential dividend right is extinguished by failure of the Board to *pay* the non-cumulative dividend in any particular year cannot be reconciled with the authorities cited above, which are unanimous in reaching a contrary conclusion.

(e) We agree that the right given to the A stock to *participate* with the common in excess dividends is dependent upon (1) a declaration by the Board exercising its discretion, which (2) must be made in that year. Whatever may be the force and effect of the use of the phrase "declared by the Board" in this connection, it is used in the contract in defining its right to *participate* in excess dividends and it is not used in that part of the contract which defines the preferential dividend rights conferred upon the A stock. The draftsman knew very well how to use that word and if he had intended that the preferential dividend right should be dependent upon a dividend declaration he would have said so. His failure to do so evidences a contrary intention.

(f) The contract provides that the A dividend rights in liquidation are dependent upon dividends thereon *declared* and unpaid. Here again in this connection the draftsman used the word "declared".

(g) Again the draftsman used the word "declared" in providing for distribution on liquidation and the same comment presented in (e) and (f) again applies.

(h) The same comment again applies based upon the use of the words "declared" and "unpaid" referred to in Petitioners' (h).

(i) We deny that the provision therein referred to granting a preferential dividend right to the B stockholders is susceptible of the interpretation placed upon it. This provision is quoted on page 38 of petitioners' brief with some words inserted in parentheses which do not appear in the original charter provision. There is an error in the fifth line of this quotation in the phrase

> "after payment of the full five per cent. *dividend* on the five per cent. profit-sharing Preferred Stock A."

In the *certificate of incorporation* of the Company (see Exhibit A to the Bill) in the second paragraph of Article Fourth (Trans., bottom of page 10), the word is "dividends", that is, the plural instead of the singular. Before any of the preferential B dividends may be paid the Preferred A stockholders are entitled to receive all of their preferential A dividends, not only those for the current year but, in addition, those earned in prior years which still remain unpaid.

It is true that the *stock certificate* issued to represent the Preferred A stock uses the word "dividend" instead of the plural (Trans., p. 18, l. 8) but that was evidently a clerical error. This certificate, contains the following:

> "Reference is hereby made to the Certificate of Incorporation of the Company *to all the provisions of which this certificate and the rights of the holder of stock represented hereby are subject,* for a statement of *the rights and privileges of and the limitations upon the various classes of the Company's stock and of the obligations of the Company with re-*

spect thereto and for its provisions generally as if herein set forth in full" (Trans., p. 19).

The *certificate of incorporation* controls.

The contract does not limit to five per cent. in a given fiscal year the amount of preferential dividends which must first be paid on the Preferred A stock, before any dividends may be paid on the Preferred B stock in such year.

On page 37 of petitioners' brief we find the following in italics:

> *"It is respectfully submitted that the stipulation that the Preferred B stockholders are entitled to dividends up to 5% in any year in which the full 5% dividend is paid upon the Preferred A stock is alone determinative of the present case."*

This is not an accurate statement of the preferential dividend right conferred upon the Preferred B stock. This paraphrase indicates that the B stockholders are entitled to their 5% *in any year in which* the A stockholders have received 5%. We deny that this is a proper paraphrase of the language of the contract which appears in the Transcript at the bottom of page 10 and the top of page 11. The condition precedent to the payment of any B dividends in any year is that all of the A dividends for that year, and in addition all of the A dividends earned in prior years which still remain unpaid, shall be first paid and satisfied.

We have discussed the force and effect of these provisions of the contract because petitioners seem to rely upon them with so much confidence. In its application to the facts of the case it is not of any particular importance, for it relates only to the status of the preferential B dividend and there is a very small amount of B stock outstanding. There

is no provision in the contract authorizing the payment of common dividends after payment of the full A and B dividends, similar to the provision authorizing the payment of B dividends after payment of the full A dividends. It therefore follows that, even if the B dividends are given the preference claimed for them, no common dividends may be paid until after all of the preferential A dividends, including those earned in prior years, are first paid and satisfied.

We are not contending, as suggested in Petitioners' brief, pp. 38-39, that the word "non-cumulative" is employed in one sense when applied to the Preferred A dividends and in another sense when applied to the Preferred B dividends. Both the Preferred A and the Preferred B stockholders are entitled to a dividend credit to the extent that their dividends are earned year by year. The fact that the Preferred A stock is given a right to participate with the Common in certain excess dividends and the Preferred B is given no such right has no influence or bearing upon the right of the A and B stockholders to receive preferential dividend credits.

Petitioners refer to the right of redemption of the A stock and of the B stock reserved by the contract and suggest that according to respondents' theory the Company, in the event of redemption, would have to pay, in addition to the redemption price, the earned but unpaid non-cumulative dividends. That may be true, but the point is not involved in the present case.

On page 41 of Petitioners' brief the statement is made that the two issues of preferred stock were made non-cumulative, so that the Board might have discretion to freely use current earnings for improvements and additions. The Board would have that same discretion if the dividends were cumulative.

In that event the preferred stockholders would have been entitled to a dividend credit to the full extent of the 5%, but, as in the present case, the A dividends being non-cumulative, the dividend credit in favor of the A stock is limited to the amounts earned upon said stock year by year.

If the last clause of the contract, which provides that the dividends shall be non-cumulative, had been omitted and the words "in each year up to the amount of 5%" had been written "at the rate of 5%", the dividends would have been cumulative. This is well established by the authorities.

Machen on Modern Law of Corporations, Sec. 551, which says:

> "*Prima facie,* the preference is cumulative."

Cook on Corporations, 8th Ed. Vol. 1, Sec. 273, which says:

> "If preferred stock is issued without any mention of whether or not the dividends are cumulative, then the law makes them cumulative."
>
> *Fidelity Trust Co.* vs. *Lehigh Valley R. R. Co.,* 215 Pa., 610.

It therefore appears that the designation of the dividends as "non-cumulative" cuts down rights which the Preferred A stockholders would otherwise have possessed. Respondents are not relying upon that word as the basis of a grant to them of any preferential dividend rights. They would have had cumulative dividend rights if the last clause of the contract had been omitted.

We submit that the language of the contract, other than the word "non-cumulative", does not sustain Petitioners'

claims, as we have analyzed them above, pages 11-12, items (a), (b) and (c). An alleged discretion vested in the Board is at the basis of each one of these claims. It is therefore necessary to consider the nature and extent of the discretion vested in the Board in regard to the payment of dividends and the effect of the exercise of that discretion.

III.

Discretionary powers of Directors in regard to dividend declarations and the effect of the exercise of that discretion.

Petitioners rely upon the discretionary powers of the Board to defeat the preferential dividend rights which Respondents claim are vested in the A stockholders by the contract. Petitioners insist that it is within the power of the Board to determine whether the A stockholders shall receive their dividends for any particular year, or whether they shall lose them.

Respondents admit, and we believe the Petitioners agree, that the Board is vested with a fair and reasonable discretion in regard to (1) the time of payment of dividends and (2) the appropriation of earnings with which dividends might be paid, to pay for permanent improvements.

The particular point of difference between Petitioners and Respondents is the effect of the failure of the Board, acting in pursuance of a reasonable discretion, to declare and pay non-cumulative dividends within the year in which they are earned and the appropriation of the earnings of

the year to pay for permanent improvements. Petitioners claim that if the Board diverts the earnings of any year, which they might use to pay dividends, to pay for permanent improvements, the non-cumulative dividends for that year, even though they are earned in the year, are lost to the preferred stockholders. Respondents deny that this is true. They contend that the result of such action by the Board is a postponement only in the payment of the dividends and that the right of priority in payment still remains intact. Respondents deny that the Board had any power to modify or control in any particular the dividend rights and preferences given by the contract to the Preferred A stock, excepting only in proper cases the right to postpone recognition of said rights and preferences.

Many contracts which define the respective dividend rights and preferences of several classes of stockholders contain clauses expressly vesting a discretion in the Board in regard to the time of payment of dividends. The language used is very frequently that the dividends are payable *when and as declared by the Board.* There is no such clause in the Wabash contract. We admit, however, that the Board has the power to postpone dividend declarations for any proper reason, but not to deprive the A stockholders of their dividend rights and preferences.

Although we admit that in the interpretation of any contract defining the respective dividend rights and preferences of stockholders the discretionary powers of the Board must be given proper consideration, there are other considerations which also must be taken into account. If, for example, inequitable results would follow from the adoption of a particular interpretation of the contract, the Court will consider carefully whether there is not some more rea-

sonable interpretation. This point was considered in the leading English case of *Henry* vs. *Great Northern Railway Co.*, 1 deG. & J. 606, in which the Court was called upon to determine the discretionary powers of the Board under a contract which defined the respective dividend rights of preferred and ordinary shareholders.

Two interpretations were suggested. The Court rejected one because it would subject the Board to a temptation to favor the ordinary shareholders against the preferred. The Court said:

> "If the directors are, as probably they will be, ordinary shareholders, they will have an interest so from time to time to set aside portions of their funds for the benefit of the company in the next half-year, as to prevent the preference shareholders from receiving a dividend in full, and they will thus create a larger fund for division on the next occasion, the entire benefit of which, on the argument of the appellants, will accrue to the benefit of the ordinary shareholders.
>
> I am aware that it will always be the duty of the directors to fix the amount of the fund retained with reference to the general interest of all classes of shareholders, and not to favor any one class at the expense of the other. But when I see that on one construction of these Acts the legislature will have given to the directors an interest in opposition to their duty, and that on the other construction they will not have done so, I am led strongly to believe that the latter is the sounder interpretation.
>
> The same reasoning is also applicable to the duty of the directors under section 120. There is no time fixed at which dividends are to be declared, and if at the end of any particular half-year the fund for division should be little more than nominal, prudence would, or might, lead the directors to postpone

the taking of any step towards the declaring of a dividend until a subsequent period. But if by declaring a dividend when the fund is merely nominal the claim of the preference shareholder is cleared up to the time of the distribution, it is obviously the interest of the ordinary shareholders that such a declaration should be made, so that here, too, the interest of the directors as ordinary shareholders may be in conflict with the duty they have to perform towards all persons interested, including the preference shareholders.

These anomalies are all avoided if we hold that the preference given by these statutes confers a right to receive dividends at the stipulated rates, not only out of the profits accrued when the dividend is declared, but, if they are insufficient, then out of subsequent profits. On such a construction, which the language well justifies, there can be no inducement to the directors, either unduly to set aside funds for enlarging the works with a view to future profit, or to propose a dividend when there is no substantial fund for distribution. The rights of those entitled to preference will be effectually secured, and the interests of the directors cannot be brought into inconvenient conflict with their duties."

Upon the authority of this case the interpretation of the contract suggested by Petitioners should be rejected and Respondents' interpretation should be accepted for the following reasons:

1. The directors might very frequently find themselves in an awkward and embarrassing position. Near the end of some particular year they will find that a non-cumulative preferred dividend has been earned, but they will hesitate to declare it, because the earnings may be needed for some other purpose which may be very important for the general

enterprise. They will wish to be fair to the preferred stockholders and not deprive them of their earned dividends. On the other hand they will see the advisability of passing these dividends and appropriating the money for some other proper corporate purpose. Their duty to the preferred stockholders will be in conflict with their duty to the enterprise, which is subject to their control. This embarrassment will be eliminated if they know that a failure on their part to declare the dividend within the year will not result in a loss to the preferred stockholders of their dividend right for that year, but will operate only as a postponement of the payment of the earned dividends.

2. The directors would be vested with a very dangerous power. Some of them may own more common stock than preferred. They will be tempted to pass preferred dividends, even though they have been earned, because in that way the dividend right will be lost to the preferred stockholders with a corresponding benefit to the common. These earned dividends will have created a credit to the surplus account, which will always be there for any proper purpose, including particularly the payment of dividends. If the non-cumulative preferred dividends for those particular years are lost, why not pay dividends upon the common stock based upon that credit to the surplus account?

3. The earnings of any particular year cannot be definitely known until after the year is over. It is not at all impossible that during the last few weeks or few days of any particular year very heavy losses may be sustained sufficient to wipe out all of the year's earnings.

4. If the earnings of any year which might be paid as preferred dividends are appropriated by the Board to in-

crease the working capital, or to pay for extensions and improvements to the property, such appropriation may very properly be considered a contribution by the preferred for the benefit of the general enterprise and an investment for their account in the business and property of the Company. The Company may require a larger working capital, or double track, or better terminal or other facilities. Why should the preferred stockholders lose any dividend rights because of that contribution and investment? All that they may properly be asked to suffer is a postponement in the payment of their earned dividends until a favorable time arrives for dividend payments. At that time their preferential dividend rights should be recognized and enforced.

The dividend credit theory presents the proper and the most reasonable solution of the problem and, according to that theory, if a non-cumulative preferred dividend is earned in any year a corresponding dividend credit is given to the Preferred A and no junior dividends may be paid by the Board until after that credit is first paid and satisfied.

The Petitioners use the same argument that we present in this sub-division of our brief. They present on page 42 of their brief two propositions and at the top of page 43 say:

> "A judicial decision construing a contract so as to create such manifest chaos could only be justified by language showing an unmistakable intent."

Their first proposition is that during the years 1916, 1917 and 1918, the Company earned $15,486,352, out of which Preferred A dividends were paid amounting to $2,310,000, leaving a balance to the credit of the surplus account of $13,176,352, of which the Preferred A stock,

according to respondents' theory, is entitled to a dividend credit of $5,283,225 and the balance, $7,893,127 represents the dividend credit of the B and common stockholders. Then follows in 1919 and 1920 operating deficits aggregating $9,918,778. The question presented is whether those deficits should be charged against the A dividend credit or the junior dividend credits or pro rata. The proper answer to that question will determine the amount of the dividend credit, according to Respondents' theory, in favor of the A stock. That question will not become important unless Respondents' position on the main case is sustained. If that should be the result, there will be no difficulty in determining this particular issue. It is discussed by Mr. Berle in his *Studies in the Law of Corporation Finance,* Chapter V, sub-division III, page 101, under the following heading:

> *"The preferred surplus fund must not be diminished by losses until the common surplus fund has been exhausted."*

We believe that that principle will be sustained.

The second proposition suggests that, if Respondents' position on the main case is sustained, there will be outstanding Preferred A stock with eighty-four different values. That would, of course, be an impossible situation. The answer is that it would not be true. Every share of Preferred A stock has the same value as every other share. Each share is entitled to its proportionate interest in the dividend credit. Additional A stock has been issued from time to time with additional common stock in conversion of the B stock under the conversion privilege given in the charter (Transcript, p. 11). It was the intention of the charter that the additional A stock thus issued in con-

version of B should have the same standing as the A stock theretofore issued and should receive the same rights and privileges, including the proper interest in the A dividend credit.

These several influences must be given their proper effect in choosing between the interpretation of this particular contract presented by the Petitioners and the interpretation presented by Respondents. As a matter of fact the present case really stands upon a firmer foundation. The discretion vested in the Board of Directors must be limited to its proper scope. On this general question Mr. Berle in his *"Studies in the Law of Corporation Finance"* uses the following language in his foreword on pages V and VI:

> "Until relatively recently the type corporation was a small concern with a closely knit body of stockholders, generally located near the business and able to stroll down to the plant or call at the office at will. Naturally, therefore, intra-corporate problems were of secondary importance. Today, with the growth of American business, the concentration into large financial units, and the increased liberality of incorporation statutes, the center of interest has shifted. The problems now revolve about financial relationships between the various participants in the corporate enterprise. For one question of corporate entity there are a thousand questions of stockholders' rights.
>
> To facilitate corporate business courts worked out the doctrine that the management should have wide discretion in conducting the business affairs of the corporation, and indulged a heavy presumption in favor of action taken under this discretion. This was fair enough; courts are not in a position to assume large responsibilities in the conduct of business. But with the increasing flexibility of corporate

charters and authorizing statutes, managements sought and secured a new type of power. This was power not to run the business of the corporation as a whole, but to *determine and adjudicate property rights as between the participants in the corporate entity.* The distinction between these two varieties of power is only just attaining recognition. But it is fundamental. Discretion in business affairs involving the enterprise as a whole is one thing; power, or discretion, if you choose to regard it as such, to determine whether or not a stockholder shall have rights in surplus, or what the book value of his stock shall be, is manifestly a horse of a different color. It involves a different relationship: that of control by one group of persons over property rights beneficially vested in another group. And it calls into play many of the considerations applied when equity assumed complete jurisdiction over trusts and uses. It is manifest that problems of procedure and of substantive law must be faced anew; and that corporation lawyers, corporate officials and investment bankers must reconsider their various positions."

The discretionary powers of directors have definite limits. They cannot be extended to include control over vested rights founded on contract.

IV.

Analysis of the cases which discuss the dividend rights of non-cumulative preferred stocks.

These cases may be divided into the following three classes:

A. Cases in which preferred stockholders whose dividends are non-cumulative have *demanded payment* of their dividends earned in prior years.

B. Cases in which the directors have voluntarily declared non-cumulative preferred dividends which were

earned in prior years but still remained unpaid and the common or other junior stockholders have sued to enjoin payment of such dividends.

C. Cases in which the Board has declared common or other junior dividends and the preferred stockholders whose dividends are non-cumulative have sued to enjoin payment.

Cases Under Subdivision A.

These are cases in which dissatisfied preferred stockholders have demanded payment of dividends earned in prior years. They present Petitioners' first two claims, analyzed on page 11, *supra*, that is, whether the dividend right is created by the dividend declaration and whether, if not declared within the year, the dividend right is lost. They do not present the third claim (p. 12, *supra*), that is, whether the Board has the right to distribute the earnings of a subsequent year in dividends, including junior dividends, even though Preferred A dividends earned in prior years still remain unpaid. In none of the cases under this heading do the complaining preferred stockholders ask for payment of their dividends out of any particular fund.

The first case to be considered under this heading is *New York, Lake Erie & Western R. R. Co.* vs. *Nickals*, 119 U. S. 296, 30 L. Ed. 363, in which preferred stockholders, whose dividends were non-cumulative, demanded payment of their dividends simply because they had been earned. The contract provided for the issue of preferred stock

> "entitling the holders to non-cumulative dividends, at the rate of six per cent. per annum, in preference to the payment of any dividend on the common stock, but dependent on the profits of each particular year, as declared by the Board of Directors."

In discussing the meaning of the word "non-cumulative" above (page 9) we cited the *Nickals* case and the definition of "non-cumulative" therein given as follows:

> "non-cumulative, because 'dependent on the profits of each particular year', and not to be fastened on the profits of succeeding years."

This is the only mention of the word "non-cumulative" in the opinion. The decision was based upon other language of the contract. The statement that a non-cumulative dividend is "dependent on the profits of each particular year" is in accord with the other authorities cited above on this point. The statement that the dividend is "not to be fastened on the profits of succeeding years" is not clear. No dividends are fastened on the profits of any year in the sense that they are secured by a lien or charge upon them, unless there is language in the contract other than the use of the word "non-cumulative" which must be given that effect. In the light of the authorities cited above on this point we think that the intention must have been to state that the *deficiency* is not to be fastened on the profits of succeeding years. However this may be, the point is not of any particular importance, for even if Petitioners should establish that the A dividends should not be fastened upon or paid out of the earnings of subsequent years, it does not follow that the preferential dividend rights given to the A stock are lost. Those dividends must be satisfied out of some other fund if not out of the earnings of subsequent years. The Board has the right to sell capital securities to raise the money to reimburse the treasury for the appropriation of earnings to pay for extensions and additions, or the money can be raised by temporary bank loans.

In the *Nickals* case this Court said:

> "The theory of the present suit is that the sum of $1,790,620.71—ascertained to be the 'net profit' derived from the operations of the Company for the fiscal year ending September 30, 1880, after paying operating expenses and fixed charges—*constituted a fund applicable, primarily, to the payment of a 6 per cent. dividend upon preferred stock.* The use of that fund for any other purpose was, it is claimed, a breach of trust on the part of the Company and a violation of rights secured to preferred stockholders, both by the plan and agreement of December 14, 1877 and by the Company's articles of association."

It was shown that the earnings of the particular year had been appropriated by the Board to pay for much needed extensions and additions. This was a matter within the discretion of the Board, for the net earnings of the year did not constitute a fund "applicable primarily" to the payment of the preferred dividend. The opinion proceeded as follows:

> "The Court below adjudged, in effect, that the *right to a dividend,* for the year ending September 30, 1880, payable out of the 'net profit' arising from the operations for that period, *was absolutely secured to preferred stockholders* both by the plan and agreement and by the articles of association. Such, it held, was the contract between the Company and the preferred stockholders, which the Court was not at liberty to disregard. *This,* in our judgment, is an *erroneous interpretation* of both the agreement and the Company's charter. There is *nothing* in the language of either necessarily *depriving the directors of the discretion* with which managing agents of corporations are usually invested when distributing the earnings of property committed to their hands."

The preferential right given the preferred was a preference in payment of their preferential dividends over the common, but not any right to payment out of any particular *fund*, or at any particular *time*.

The Court further said in discussing the agreement:

"• • • That instrument did, indeed, provide for preferred shareholders being paid a dividend of 6 per cent. *before any dividend was paid to common shareholders.* But it was not intended to confer upon the former *an absolute right to a dividend in any particular year, dependent alone on the fact,* or the official ascertainment of the fact, that there were profits in that year, after paying operating expenses and fixed charges. The words of the 13th Article 'as declared by the Board of Directors' do not qualify the words 'dependent on the profits for each particular year.' They should rather be read in connection with the preceding words, 'non-cumulative dividends, at the rate of 6 per cent. per annum, *in preference to the payment of any dividend on the common stock'* • • • We are of opinion, that while the agreement of 1877 and the articles of association sustain the claim of the preferred stockholders to a 6 per cent. dividend *in advance of common stockholders, the former are not entitled of right, to dividends, payable out of the net profits accruing in any particular year, unless the directors of the Company formally declare, or ought to declare, a dividend payable out of such profits; and whether a dividend should be declared in any year is a matter belonging in the first instance to the directors to determine, with reference to the condition of the Company's property and affairs as a whole.* As the evidence shows that the profits for the year ending September 30, 1880, were applied to objects that were legitimate and proper, and as the condition of the Company was not such as to make

> the declaration of the dividend a duty upon the part of the directors, we perceive no ground upon which the claim of the appellees can be sustained."

The net profits of any year may be used in the discretion of the Board to pay the cost of permanent improvements. This does not mean that if so used the preferred dividend right for that year is lost. This Court held to the contrary, for it said in the first sentence of the last quotation that the instrument provided for the payment of preferred dividends

> "before any dividends were paid to common shareholders"

and a little lower in the same quotation for the payment of preferred dividends

> "in preference to the payment of any dividend on the common stock"

and, again, that the Articles sustain the claim of the preferred

> "to a 6 per cent. dividend in advance of common stockholders."

and again, that the preferred stockholders

> "are not entitled, of right, to dividends, payable out of the net profits accruing in any particular year."

There is nothing to indicate that the preferred dividend right for any year is lost because of the appropriation of the earnings, with which they might be paid, to pay the cost of permanent improvements.

In the present case if Respondents had demanded payment of their earned dividends for prior years instead of

asking for an injunction to restrain payment of junior dividends, that demand would have been denied. It is true that there is no "when and as clause" in the Wabash contract vesting express discretion in the Board in regard to the time of payment of dividends, but the contract does not authorize a demand for payment of the Preferred A dividends simply because they have been earned. It grants the right to the Preferred A stock to receive the preferential dividends payable before any junior dividends are paid and this includes A dividends earned in prior years as well as current A dividends.

There is nothing in the opinion in the *Nickals* case which sustains Petitioners' claim that the right to receive a non-cumulative preferred dividend is dependent upon a dividend declaration, and if not declared within the year the dividend right is lost.

Another case upon which Petitioners rely with confidence is *Continental Insurance Co.* vs. *United States,* 259 U. S. 156, 66 L. Ed. 870 (1922). This suit was brought by common stockholders who demanded in the distribution of assets on dissolution an award in their favor of an amount equal to the dividends which they claimed the Board might have declared upon the common stock in prior years. The suit therefore was not brought by preferred stockholders demanding declaration and payment of preferential dividends, nor was the suit filed until after the Company had gone into involuntary liquidation. The case is therefore different from the present case.

The contract is quoted on page 16 of Petitioners' brief. It is very much more elaborate than the Wabash contract and the respective dividend rights and preferences are not the same. If before liquidation the Board had undertaken

to distribute in dividends the earnings of a subsequent year in the order of the respective dividend priorities, including common dividends, even though non-cumulative preferred dividends earned in prior years still remained unpaid, that action under the particular language of this contract would perhaps have been sustained. This Court, speaking through Chief Justice Taft, said:

> "We come now to the issue upon which these appeals were brought here. It concerns the respective rights of the common stockholders and the preferred stockholders in the assets of the Reading Company. * * * (p. 176)
>
> What is to be done is, in fact and law, a liquidation of the assets of the old Reading Company. * * * (p. 177)
>
> The rights of the common and preferred stockholders of the Reading Company *inter sese* are to be determined by the organization agreement of 1896. * * * (p. 177)
>
> Our conclusion that the claim on behalf of the common stockholders is invalid is based on the construction of the words of the agreement itself and hardly needs authority to sustain it. It is, however, in accord with the general common law rule that stockholders, common and preferred, share alike in the assets of a liquidating corporation, if the preference is only as to dividends." (p. 181)

Petitioners quote from the opinion on pages 17 and 19 of their brief. Note the following sentence near the top of page 18 in speaking of the contract:

> "It leaves to the Board to determine in its discretion whether the undivided profits shall be put in surplus working capital or in dividends."

and the sentence near the bottom of the same page, in speaking of this discretion:

> "The failure of the board to exercise it, and the application of the earnings to surplus determine such earnings to be assets as of the time of the compulsory winding up and liquidation of the corporation."

and the further sentence near the top of page 19:

> "The proper interpretation of the agreement is that, after the declaration of dividends for any current year, the undivided earnings are to be regarded as capital assets and to be distributed on liquidation, unless the board of directors has meantime applied them as dividends."

The Court therefore held that the Board at any time prior to dissolution might have declared these common dividends out of the surplus which had been created by the excess earnings of prior years but, under the particular terms of the contract, if no such dividends had been declared prior to dissolution, the earnings at that time became capital assets and subject to distribution as such on liquidation.

A radical defect in Petitioner's claim in this case was that by his bill he demanded payment of dividends and it is elementary that in order to sustain any such demand he must prove that the Board abused its discretion in failing to pay them. No such abuse of discretion was shown.

The case did not involve the respective dividend rights of the preferred and common stockholders. No issue was presented involving the *dividend* rights of any stockholders. The situation in that regard was vitally changed when the Company went into liquidation. The distribution of the

assets in liquidation was expressly provided for by the contract. The basis for Respondents' case is that by the terms of the contract the Preferred A stockholders are given a dividend credit. That credit means a right to receive dividends up to the amount of the credit before any dividends may be paid upon junior stocks. The contract gives no such right to the common stockholders.

No one of the three points analyzed above at pages 11 and 12, representing Petitioners' position as we understand it, was involved in this case.

After discussing the Continental Insurance Company case Petitioners in their brief, page 20, say that the financial structure of the Reading Company is typical of most of the great railroad transportation companies in the country and in a note they cite a great many railroad non-cumulative preferred stocks, and in a note on page 22 they cite certain non-cumulative preferred stocks on which the non-cumulative dividends earned in prior years still remain unpaid, while dividends have been paid upon junior stocks. Each contract must necessarily be interpreted according to its terms and provisions. The fact that there may be outstanding a great many non-cumulative preferred stocks and that on many of them the non-cumulative preferred dividends for prior years were earned and remain unpaid, while the management has inaugurated a policy of paying dividends upon junior stocks, does not assist us in determining the issues presented in the present case.

In *Star Publishing Co.* vs. *Ball,* 192 Ind. 158, 134 N. E. 285, the suit was instituted by preferred stockholders whose dividends were 5% non-cumulative and payable when earned and declared. The contract also contained a preference clause, that no common dividends should be paid until full payment of the preferred dividend. During the period from 1911 to 1918 the Company was prosperous and could

have paid preferred dividends. It was at that time controlled by the owner of a large block of common stock. The bill charged that the directors had abused their discretion in failing to declare and pay preferred dividends and this charge was sustained. The Court said that during this period the Company

> "could have paid dividends on the first days of March, June, September, and December at the rate of 5 per cent. per annum on its shares of preferred capital stock without depleting its cash assets, impairing its solvency, injuring its business or the rights of its shareholders."

The preferred stockholders asked for an award of $62,125 of earned but unpaid dividends. Under the record it was not clear whether the Board had not acted properly in retaining $23,075 as an addition to the working capital The Court held that under the facts a duty was imposed upon the Board to declare non-cumulative preferred dividends for prior years to the extent of $39,050. The Company's position was shown by the following quotation from the opinion:

> "Appellant claims that appellee waived his right to dividends by acquiescing in the use of the net earnings and profits of the Company in paying the mortgage debt. In this appellant is in error. It merely suspended the appellee's right until there was an excess of earnings over the amounts reasonably required to be expended for that purpose. It is nowhere made to appear from the special findings that appellant was in any way prejudiced or misled by the conduct of appellee."

The Board was within its rights in using earnings with which preferred dividends might have been paid to pay the

mortgage debt, but the Court held that the failure to declare those dividends within the year and the appropriation of the money to pay this debt did not result in a loss to the preferred stockholders of their dividend rights, but only in a suspension of those rights until the time came later for the declaration and payment of dividends.

Petitioners endeavor to make some capital out of the fact that certain common dividends had been paid while earned preferred dividends for prior years remained unpaid. It does not appear that the preferred stockholders asked the Company to proceed against the common stockholders for the return of those dividends improperly paid, nor does it appear that there was any assignment of error based upon the payment of said common dividends. The fact that common dividends had been paid was not discussed by the Appellate Court, although it was incidentally mentioned.

There is no discussion in the opinion of the meaning of the word "non-cumulative". The preferred stockholders limited their claim for payment to the amount of preferred dividends earned in prior years.

This case denies Petitioners' first point, that a non-cumulative dividend right depends upon and is created by a dividend declaration, also Petitioners' second point, that a non-cumulative preferred dividend for any year, even though earned in that year, is lost if not declared within that year. Petitioners' third point, that is, the right of the Company to pay dividends to the several classes of stockholders out of the earnings of a subsequent year, was not involved. It is true that the Board had abused its discretion in regard to the payment of dividends. Notwithstanding that fact, the Court held that the Board was justified in using earnings with which dividends might have been

declared to pay a mortgage debt. Therefore there was no abuse of discretion in that act and yet the effect of that act was not a loss of the dividend right, but a suspension only.

In *Burk* vs. *Ottawa Gas & Electric Co.*, 87 Kans. 6, 123 Pac. 857 (1912), preferred stockholders of the defendant Company brought suit demanding payment of their non-cumulative dividends to the extent that they had been earned. Earnings with which these dividends might have been paid had been used to pay for extensions and additions to the property. The contract read as follows:

> "The preferred stock shall carry a six per cent. per annum preferred non-cumulative dividend, payable semi-annually on the first days of July and January of each year after January 1, 1906, out of the net profits of the preceding fiscal year, and a *pro tanto* dividend if such dividend shall fall short of 6 per cent."

The dividends were not made payable when and as declared by the Board, nor was there any clause providing for payment before any common dividends should be paid. The dividends were, however, expressly designated "non-cumulative". The Court held that the obligation to pay the dividends was absolute and that the Board had no right, even to appropriate the earnings, with which they might be paid, to pay the cost of permanent improvements.

The Court said:

> "The fair interpretation of the contract between the corporation and the holder of this stock is that, if in any year net profits are earned, a dividend is to be declared. To hold that the Board of Directors—that is to say, the corporation—has a discretion to declare or not to declare a dividend when it has funds that it can use for the purpose, is to hold that one

> of the parties to the contract has the option to pay something to the other or not, at his own election, * * * "

And again:

> "The directors of the corporation owed a positive duty to pay a dividend to the preferred stockholders whenever in any year there were net profits available. The funds that might be used for that purpose could not rightfully be expended for extensions merely for the benefit of the business, nor could they be withheld to meet the expenses of the next year."

Although the preferred dividend was expressly designated "non-cumulative", the Court held that the Company had no power whatever to appropriate the earnings to pay for extensions and additions to the property, instead of using them to pay the non-cumulative preferred dividends. It was a violation of the preferential dividend right conferred upon the preferred stockholders for the Board to appropriate these earnings to pay for extensions and additions instead of dividends, even though in the exercise of a fair and reasonable discretion the Board no doubt thought that it would be better for the interests of the enterprise to pursue this course. Even though the preferred dividends were designated "non-cumulative", the contract vested definite dividend rights in the preferred stockholders which the Board had no power to disregard.

Cases Under Subdivision B.

These are cases in which the directors have voluntarily declared non-cumulative preferred dividends for prior years and common or junior stockholders have sued to enjoin payment.

In *Wood* vs. *Lary*, 47 Hun 550 (1888), 124 N. Y. 83, the charter provided that the preferred stockholders

> "were entitled to dividends not to exceed 6% payable semi-annually, not cumulative, whenever in any year the net earnings, after payment of all interest charges, shall suffice for payment thereof."

The Company earned dividends over a period of four years, but the Board used those earnings to pay for the construction of permanent improvements instead of paying dividends. The common stockholders sued, alleging that the preferred dividends were non-cumulative and on that account the directors had no right to declare them for prior years. Presiding Justice Van Brunt said:

> "But it is urged that the certificate, being non-cumulative, the directors had no right to declare a lump dividend for four years."

The Court then discussed and distinguished the *Nickals* case on the ground that in that case the preferred dividends were payable "as declared by the Board of Directors". The opinion proceeded as follows:

> "In the case at bar, however, the language used in the certificate is different and seems to confer a right which did not exist in the case cited.
>
> The provision of the certificate is that the holder is entitled to dividends whenever in any year the net earnings, after payment of all interest charges, are sufficient for the payment thereof. This places the question of their rights beyond the discretion of the directors and gives the preferred stockholders a right to these profits as dividends, after payment of the interest charges mentioned in the certificate.
>
> Under these circumstances, whether the directors declared a dividend of these profits arising in each

> year or not, the stockholders were entitled to the same, and perhaps by proper proceedings could have enforced payment of the same at the end of each year. Therefore, the right of the stockholders to these profits became fixed, and even if the directors made no division thereof, that right still existed and could not be taken away. The subsequent compliance by the directors with the terms of the contract in the declaration of the dividend did not, therefore, infringe upon the provision of the certificate which made the dividend non-cumulative."

These non-cumulative preferred dividends earned over a period of four years were declared by the Board payable in bonds, the earnings with which they might have been paid having been used for construction account. The non-cumulative dividends had not been declared within the year, but notwithstanding that fact the Court held they were not lost. These dividends were not paid out of the earnings of a subsequent year, nor out of the general surplus. They were paid in bonds and that course was approved.

It seems quite clear that if, while these earned non-cumulative preferred dividends still remained unpaid, the directors had undertaken to declare and pay common dividends, the preferred stockholders would have been entitled to an injunction to enjoin payment.

The opinion from which the above quotation is taken is the opinion of the Supreme Court, General Term. An effort was made to appeal the case to the Court of Appeals, but the appeal was dismissed because the trial court failed to state the facts found and the conclusions of law, as required by the Code. The Court of Appeals, however (124 N. Y., pp. 87, 88), used the following language in regard to the merits of the case:

"An examination of the questions to which the counsel for the appellant called our attention on the argument led to the conclusion that no error was committed at General Term, but as we have concluded that the appeal ought to be dismissed, the occasion does not call for an expression of the reasons inducing such conclusion."

The next cases to which we wish to call attention are the Cast Iron Pipe and Foundry Company cases in New Jersey, as follows:

Bassett vs. *United States Cast Iron Pipe & Foundry Co.*, in the Chancery Court, 74 N. J. Eq. 668, 70 Atl. 929 (1908), and in the Court of Errors and Appeals, 75 N. J. Eq. 539, 73 Atl. 514 (1909);

Moran vs. *United States Cast Iron Pipe & Foundry Co.*, in the Chancery Court, 95 N. J. Eq. 389, 123 Atl. 546 (1924), affirmed in the Court of Errors and Appeals, 96 N. J. Eq. 698, 126 Atl. 329 (1924);

Day vs. *United States Cast Iron Pipe & Foundry Co.*, in the Chancery Court, 95 N. J. Eq. 389, 123 Atl. 546 (1924), affirmed in the Court of Errors and Appeals by a divided court, 96 N. J. Eq. 736, 126 Atl. 302 (1924).

The Cast Iron Pipe and Foundry Company contract was more elaborate than the Wabash contract in defining the respective dividend rights of the non-cumulative preferred stock and the common stock, but in substance was the same.

The *Bassett* suit was instituted by a common stockholder to enjoin the payment of a preferred dividend earned in prior years and made payable out of a Reserve

Fund, for which Section 47 of the New Jersey Corporation Act provided. The substance of that section is quoted on page 23 of Petitioners' brief. The Company defended its declaration of non-cumulative preferred dividends out of that fund and the Court sustained that position. The common stockholder further contended that the Board had no right to declare non-cumulative preferred dividends which had been earned in prior years. The Appellate Court said:

> "The complainant is a holder of common stock of the defendant company. His contention in the court below and here, was, and is, that the dividends on preferred stock for any fiscal year must be paid out of the profits made during that year; that the profits of any given year which are not distributed in dividends declared in that year belong to the common stockholders, and when distributed must be paid to them to the exclusion of the holders of preferred stock. The defendant's claim is that it may pay dividends on its preferred stock out of any and all surplus net profits, without regard to the period during which they were earned. The learned vice-chancellor who heard the cause adopts in his opinion the contention of the defendant upon this point.
>
> It seems to us that neither the contention of the complainant nor that of the defendant is altogether sound. On the one hand, the corporation has no right to accumulate a reserve fund from earnings which would otherwise be paid out as dividends to the holders of common stock, and afterward use it to pay dividends to the preferred stockholders when the net profits of the year for which the dividend is declared are not sufficient for that purpose. On the other hand, when the reserve fund is accumulated, in whole or in part, by the cutting down of dividends which would otherwise have been paid to preferred stockholders, that fund, so far as it represents

moneys so retained, is available for the payment of subsequent dividends upon the preferred stock. To yield to the contention of the complainant would be to permit the directors of the corporation to defraud the preferred for the benefit of the common stockholders; while to sanction the claim of the defendant would be to put it in the power of the directors to defraud the common for the benefit of the preferred stockholders."

In this case the dividend was declared after the year, in which it was earned, had expired. The dividend right was not lost because of the failure of the Board to declare the dividend within the year.

In the *Moran* case the bill was filed by a common stockholder to enjoin the payment of non-cumulative preferred dividends earned in prior years, out of the earnings of subsequent years, from which earnings the Company had already declared and paid the preferred dividend for that year. The bill charged that the Board had no right to pay more than the full current preferred dividend in any particular year.

The Vice-Chancellor said:

"Section 18 of the corporation act of 1896 (P. L. page 283) provides, as to preferred stock, that:

'The holders thereof shall be entitled to receive, and the corporation shall be bound to pay thereon, a fixed yearly dividend, to be expressed in the certificate, not exceeding eight per cent., payable quarterly, half yearly or yearly, before any dividend shall be set apart or paid on the common stock.'

This obviously means, as to non-cumulative dividends, that out of the profits of any fiscal year, not

> more than the percentage fixed by the charter shall be paid on such stock for such year, but it does not prohibit the Company, after having paid the fixed yearly dividend, from, in the same year, declaring and paying additional dividends out of profits earned in prior years applicable to dividends for such years, and which, but for holding them in reserve for economic reasons, would have been distributed in dividends in those years. These profits belong primarily to the preferred stockholders and the directors are in no wise restricted either as to amount, time or occasion when distribution shall be made."

The decision of the Vice-Chancellor was sustained by the Appellate Court

> "for the reasons stated in the opinion filed in the court below by Vice-Chancellor Backus, 123 Atl. 546."

Here again the dividend declaration was made long after the end of the year in which it was earned and for which it was declared. The dividend right had not been lost because there was no dividend declaration within the year. In this case the non-cumulative preferred dividend was declared out of the earnings of a subsequent year. The dividend right for any year was therefore not limited to payment of the dividend out of the earnings of that year.

In the *Day* case a preferred stockholder sued to enjoin the Company from paying common dividends because non-cumulative preferred dividends for prior years still remained unpaid. We have inserted liberal quotations from the opinion of the Vice-Chancellor at page 7 above and from the opinion of Judge White in the Court of Errors and Appeals at page 8 above. The preferred stockholder was granted his injunction for which his bill prayed. The non-cumulative preferred dividends which formed the

basis for the bill had been earned in prior years and still remained unpaid and the declaration of the common dividend was made after the expiration of said years. That fact, however, was held not to affect the non-cumulative dividend rights and preferences of the preferred stockholders.

The Court of Errors and Appeals was evenly divided in this case. An elaborate opinion was filed by Judge White sustaining the Vice-Chancellor, but no opinion was filed on behalf of the members of the Court who dissented. Judge White's decision shows quite clearly the basis of the dissent. It related to the force and effect of certain clauses in the contract which authorized the payment of common dividends out of the excess earnings of any particular year remaining after payment of the preferred dividends for that year. The dissenting judges argued that these clauses authorized the payment of common dividends out of said excess earnings even though earned preferred dividends for prior years still remained unpaid. Judge White held that these clauses give the Board no right to declare common dividends until not only the preferred current dividends were paid, but also all preferred dividends earned in prior years which still remained unpaid. That conclusion settled the case. Section 18 of the Corporation Act influenced the decision of the dissenting judges, but not the decision of Judge White and those who agreed with him. Neither Section 18 nor Section 47 had any effect upon the decisions of any of these *Cast Iron Pipe and Foundry Company* cases. In the *Day* case the Vice-Chancellor discussed Section 18 and held that it

> "is nothing more or less than a definition of the equitable rights of the preferred stockholders arising out of the Company's obligation to pay the yearly fixed dividend."

Neither statute had any effect whatever upon the Court's interpretation of the word "non-cumulative". That is very clearly shown in the quotations from the Vice-Chancellor's decision and Judge White's decision inserted above, pages 7 and 8.

We have discussed the *Day* case under this heading, although it really belongs under Subdivision C. Our reason for doing this was that it seemed appropriate to discuss all of these *Cast Iron Pipe and Foundry Company* cases at one point.

The next cases to which we wish to call attention are *Collins* vs. *Portland Electric Power Company* in the District Court, 7 Fed. (2nd) 221, affirmed in the Circuit Court of Appeals, 12 Fed. (2nd) 671, and its companion case entitled *Kurtz* vs. *Portland Electric Power Company*, reported with the *Collins* case.

In the *Collins* case the complainant was a common stockholder seeking to enjoin the payment of non-cumulative preferred dividends which had been earned in prior years on the ground that as the dividends had not been declared within the year the dividend right for that year was lost. In the *Kurtz* case the bill was filed by a preferred stockholder seeking to enjoin the payment of common dividends until after all of the non-cumulative preferred dividends earned in prior years were first paid and satisfied. The *Kurtz* case, therefore, just as the *Day* case, qualifies under Subdivision C, but is discussed here because it seems more appropriate to discuss it with the *Collins* case. The preferred stockholders won in both cases.

Judge Wolverton in the District Court said:

> "The board of directors, while authorized and entitled to exercise a large discretion respecting the

time and conditions under which the dividends shall be paid, may not, by any process of indirection, defeat the basic right of second preferred stockholders to payment of interest. * * *

As we have seen, the second preferred stockholders' dividend right to receive their interest prior to the setting apart of any dividend upon the common stock is a basic and primary right, made so by the express terms of the contract."

And again:

"This brings us to a discussion of the primary right of the second preferred stockholders to receive their interest when dividends are declared for payment. In argument the clause 'the dividends upon the second preferred stock shall not be cumulative' is stressed. This is a qualification of the primary right, and is likewise controlling with the board of directors in declaring dividends. The term 'cumulative' is so specifically defined as to need no elucidation. It is thought, in one presentation, to be the antithesis of non-cumulative; that is to say, if no dividend is declared in any one year when there is a surplus applicable, none can be declared in any year later, because it is argued that to do this would be to make that which is declared non-cumulative cumulative. The argument is not persuasive."

And again:

"The board of directors may, if the exigencies demand, set aside such surplus for economical or legitimate purposes, or may allow it to accumulate with earnings of succeeding years before declaring further dividends; but the condition remains that, for the particular year, the second preferred stockholders have earned either a part or the whole of

> their annual interest, and dividends are not declared for payment thereof through the adverse exercise by the board of directors of its discretion in one or other of the instances mentioned above. Payment being thus deferred, what right, if any, have the second preferred stockholders to dividends out of appropriate surplus accumulations that may appear in subsequent years?"

In the Circuit Court of Appeals Judge Gilbert said:

> "The controversy between the parties on this appeal is narrowed to the issue whether dividends upon the second preferred stock are lost if not declared and paid within the year, notwithstanding that there may have been earnings sufficient to pay all or part thereof, or whether the fact that the earnings were made gave to the holders of the second preferred stock a positive right to dividends out of the said earnings, with the result that the directors might lawfully declare and pay such dividends in subsequent years."

And again:

> "In the present case, the directors, by declaring dividends for the years 1921 and 1923, have recognized that the dividends ought to have been declared for those years, and that the condition of the company's property and affairs as a whole justified their later action in declaring them."

These two cases fully sustain the position taken in the present case by the Respondents and deny the contentions of Petitioners. It is important to note that the decision in the *Kurtz* case is directly contrary to contention (c) of Petitioners (p. 12). The *Kurtz* case held that non-cumulative preferred stockholders were entitled to an injunction restraining the payment of a common dividend for a year

in which non-cumulative preferred dividends had first been paid, until such time as the Board of Directors declared and paid earned dividends for prior years on the non-cumulative preferred stock.

Cases under Subdivision C.

These are the cases in which preferred stockholders, whose dividends are non-cumulative, have sued to enjoin payment of common dividends on the ground that preferred dividends earned in prior years still remain unpaid. *Day* vs. *Cast Iron Pipe & Foundry Company* qualifies in this class; also, *Kurtz* vs. *Portland Electric Power Company.* Both of these cases have been discussed with their companion cases under Subdivision B above.

The third case in this class is *Norwich Water Power Company* vs. *Southern Railway Company,* 11 Va. Law Review (N. S.) 203. That case is cited and relied upon by Petitioners. It is exceptional in other respects than that mentioned by Petitioners in their brief at page 33. The contract, which defined the respective dividend rights of the non-cumulative preferred and the common stocks, was:

> "The Common Stock is subject to the prior rights of holders of Preferred Stock at any time outstanding, according to the preferences thereof. The Preferred Stock is entitled to the following preferences and to no other, viz.: In each and every fiscal year after the first day of July, 1895, to receive non-cumulative dividends at and up to the rate of five per cent. per annum in preference and priority to the payment of any dividend on the Common Stock in such fiscal year, but only from the net profits of the Company as such shall be fixed and determined by the Board of Directors and only when and as such Board shall declare dividends therefrom; *but, notwithstanding the preference hereby declared, if, after*

providing for the payment of dividends for any fiscal year on the Preferred Stock outstanding in such year, there shall remain a surplus of net profits of such year, the Board of Directors may declare and pay dividends upon any other stock of the Company for such year out of such surplus net profits.''

The dividend which the bill asked the Court to enjoin was authorized by the express language of the latter part of the contract, that is, the part which we have italicized. That dividend was declared on the common stock in 1924 out of the earnings of 1923, after dividends of five per cent. upon the preferred stock had been declared out of the earnings of that year. Chancellor Crump said:

> ''The second clause commencing 'but notwithstanding the preference hereby declared' unquestionably means that disregarding the fact that to the extent just declared a preference to the dividends in any fiscal year has been given, yet, looking at it as if such preference did not exist 'if after providing for the payment of dividends for any fiscal year on the preferred stock outstanding in such year there shall remain a surplus of profits of such year, the Board of Directors might declare and pay dividends upon any other stock of the Company for such year out of such surplus net profits'.''

This result was required by the express language of the contract other than the word ''non-cumulative''. The Chancellor's interpretation of that word was not necessary to the decision. That interpretation is not in accord with the numerous authorities on the point cited in this brief.

It is interesting to note that one of the authorities upon which Chancellor Crump relied for his interpretation of the word is Machen on Corporations, Sec. 551, which we have

cited above (p. 4) in support of our interpretation of the word. It is difficult to understand the Chancellor's citation of that authority. It is directly opposed to his conclusion.

The present case qualifies in this class. The analysis of the cases would not be complete without reference to the very able opinion filed by the majority of the Court in the Circuit Court of Appeals in the present case. The various propositions presented by both sides were carefully considered and determined. The dividend credit theory upon which Respondents relied was expressly adopted. The entire opinion is important but the substance of the decision is shown in the last paragraph (Trans., p. 117), which reads as follows:

> "The failure of the board of directors to declare Preferred A dividends and the appropriation of the earnings with which they might have been paid to increase the working capital and to pay for construction of extensions and additions, we hold resulted only in granting a dividend credit which, at some postponed date, may be paid to Preferred A stockholders as dividends under the terms of the contract. They are still entitled to receive such dividends and the Board may not pay dividends upon junior stocks until after these earned dividends of Preferred A stock are first paid and satisfied."

V.

The decision of the Circuit Court of Appeals for the Second Circuit should be affirmed.

Respectfully submitted,

WILLIAM R. BEGG,
JOSEPH S. CLARK,
ELLIS AMES BALLARD,
Counsel for Respondents.

FILE COPY

Nos. 37-38

OCTOBER TERM, 1929.

IN THE

Supreme Court of the United States

WABASH RAILWAY COMPANY, MYRON S. HALL, H. W. COHU, et al., Petitioners,

v.

JOHN C. BARCLAY and WILLOUGHBY COMPANY, Respondents.

SHIRLEY P. AUSTIN, Petitioner,

v.

JOHN C. BARCLAY and WILLOUGHBY COMPANY, Respondents.

PETITION OF THE RESPONDENTS FOR A REHEARING.

WILLIAM R. BEGG,
JOSEPH S. CLARK,
ELLIS AMES BALLARD,
Counsel for Respondents.

Supreme Court of the United States

OCTOBER TERM, 1929. NOS. 37-38.

Wabash Railway Company, Myron S. Hall, H. W. Cohu, et al.,

Petitioners,

v.

John C. Barclay and Willoughby Company,

Respondents.

Shirley P. Austin,

Petitioner,

v.

John C. Barclay and Willoughby Company,

Respondents.

PETITION FOR REHEARING.

Now come the above named Respondents, John C. Barclay and Willoughby Company, and present this, their Petition for a Rehearing of the above entitled cause, and in support thereof respectfully show:—

The case is an important one, otherwise this Court would not have granted the petition for *certiorari* and, in addition, the opinion affects seriously not only the dividend rights claimed by the Preferred A stockholders, but also similar rights claimed by the holders of the large amounts of non-cumulative preferred stock issued by railroad and other companies operating in this country. In view of the importance of the case the basis of the decision should be fully discussed and considered.

The particular dividend the payment of which the Bill seeks to enjoin is a dividend on the Preferred B stock declared on November 30, 1927, payable on February 6, 1928, out of the excess earnings of 1927 and not out of the general surplus (Paragraph 13 of the Statement of Claim and Answer and Affidavit of Begg, Record, pp. 8, 33 and 63) and, so far as there is any indication in the record, it was the intention of the Company to pay additional B dividends and common dividends out of similar annual excess earnings.

The issue is the meaning of the word "non-cumulative." On this point the Court adopted the common understanding of lawyers and business men, which is stated in the following language:—

> "We believe that it has been the common understanding of lawyers and business men that in the case of non-cumulative stock entitled only to a dividend if declared out of annual profits,

if those profits are justifiably applied by the directors to capital improvements and no dividend is declared within the year, the claim for that year is gone and cannot be asserted at a later date."

This sentence suggests the following points:—

(*a*) Is the Preferred A stock "entitled only to dividends if declared out of the annual profits"? Dividends are more frequently paid out of the general surplus. Is there any common understanding of lawyers and business men to the effect that non-cumulative preferred stockholders have no right to dividends declared out of the general surplus created in whole or in part by the earnings of prior years which might within those years have been declared to said stockholders as dividends? Have they any understanding in regard to such dividend rights? Is not any understanding they may have on the subject limited to this: That if the annual profits are justifiably applied to capital improvements the non-cumulative dividend rights for that year, so far as payment out of those profits is concerned, are lost?

(*b*) Is it not a part of their understanding that if non-cumulative dividends for a particular year are earned and declared within the year, payable out of the general surplus, the stockholders have some rights in such dividends; or do they understand that all such dividends belong to the common stockholders?

(*c*) Was not this understanding the result of the decision in the Nickals case in which the demand for a declaration and payment of non-cumulative preferred dividends for a prior year was denied because the annual earnings had been applied to pay for capital improvements? It is admitted that the point involved here was not involved in that case. That case has been fully discussed in Respondents' Brief at pages 9 and 28.

(*d*) Even though annual earnings may be used to pay for capital improvements the treasury may be reimbursed in the future by sale of capital securities and the proceeds may be used at that time to pay dividends, or the Board may pay a dividend in stock issued against such capital improvements. Any such dividends will be charged against the general surplus accumulated in past years. Have non-cumulative preferred stockholders no interest in such dividends?

Notwithstanding the application of the net earnings of prior years to capital improvements said earnings were credited to the surplus account, which appears on the liability side of the balance sheet, and a corresponding addition to the plant and property account appears on the other side. As of December 31st, 1925, this surplus account amounted to over $27,000,000. (Record, p. 64) of which approximately $16,000,000. represented the earnings of prior years which might have been used to pay Preferred A dividends (Record, p. 66).

Many of the cases cited in Respondents' Brief involved non-cumulative dividends for prior years paid out of the general surplus and the dividend right of the preferred stockholders was recognized over the objection of the common stockholders.

(*e*) Is it necessary that a declaration of a non-cumulative dividend shall expressly state that the dividend is paid out of the profits of a particular year rather than out of the general surplus? What is the understanding on that point?

Many contracts defining the respective dividend rights of non-cumulative preferred and common stockholders expressly authorize the payment of common dividends out of the earnings of subsequent years even though non-cumulative preferred dividends earned in prior years still remain unpaid. Note the Southern Railway contract referred to in the Norwich Water Power case (Respondents' Brief, p. 51), and the Reading Railway contract discussed in the Continental Insurance Company case (Respondents' Brief, p. 33). There is no such provision in the Wabash contract.

(*f*) If as in the present case a part only of the earnings of a particular year are applied to capital improvements and another part to increase the working capital, does this fact affect the conclusion, or the understanding of lawyers and business men?

(*g*) This understanding as defined in the opinion is not in accord with the meaning of the word "non-

cumulative" which is recognized in the decided cases and text books, all of which are discussed in Respondents' Brief commencing with the Dent case in 1880 and ending with the decision of the Circuit Court of Appeals in the present case, of which authorities the lawyers are presumably advised.

We respectfully submit that there is no proof in the record of any such common understanding, nothing to advise us as to its extent or limitations, that no particular point was made in regard to it either in the briefs or in the oral argument, both parties citing the decided cases and text books in support of the meaning of "non-cumulative" presented by each, that the stockholders whose rights are dependent upon the meaning of that word include not only lawyers and business men but many others who do not qualify in either class, and that if a rehearing is granted this very important matter can be fully discussed and presented.

For the foregoing reasons it is respectfully urged that this Petition for a Rehearing be granted, and that the decree of the Circuit Court of Appeals for the Second Circuit be, upon further consideration, affirmed or modified.

Respectfully submitted,

WILLIAM R. BEGG,
JOSEPH S. CLARK,
ELLIS AMES BALLARD,
Counsel for Respondents.

CERTIFICATE OF COUNSEL.

I, Joseph S. Clark, counsel for the above named Respondents, do hereby certify that the foregoing Petition for a Rehearing of this cause is presented in good faith and not for delay.

JOSEPH S. CLARK,
Counsel for Respondents.

SUPREME COURT OF THE UNITED STATES.

Nos. 37 and 38.—October Term, 1929.

Wabash Railway Company, Myron S. Hall, H. W. Cohu, et al., Petitioners, vs. John C. Barclay and Willoughby Company. (37)	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.
Shirley P. Austin, Petitioner, vs. John C. Barclay and Willoughby Company. (38)	

[January 6, 1930.]

Mr. Justice Holmes delivered the opinion of the Court.

This is a bill by holders of first preferred stock (called Class A) of the Wabash Railway Company, to have it declared that holders of such stock are entitled to receive preferential dividends up to five per cent. for each fiscal year from 1915 to 1926 inclusive to the extent that such dividends were earned in such fiscal years but were unpaid, before any dividends are paid upon other stock; and that the Company may be enjoined from paying dividends upon preferred stock B or common stock unless it shall first have paid such preferential dividends of five per cent. to the extent that the Company has had net earnings available for the payment and that such dividends remain unpaid. The case was heard upon bill and answer. The bill was dismissed by the District Court but the decree was reversed by the Circuit Court of Appeals, one of the Judges dissenting, 30 F. (2d) 260, and a writ of certiorari was granted by this Court. 279 U. S. 828.

The railway company was organized in 1915 under the laws of Indiana with three classes of capital stock: shares of the par value of $100, of Five Per Cent. Profit Sharing Preferred Stock A; shares of the same par value of Five Per Cent. Convertible Preferred Stock B; and shares of the same par value of Common Stock. At the date

of the bill there were 693,330.50 shares of A, 24,211.42 B and 666,977.75 common. From 1915 to 1926 there were net earnings on most of the years but for a number of years no dividend, or less than five per cent., was paid on Class A, while $16,000,000 net earnings that could have been used for the payment were expended upon improvements and additions to the property and equipment of the road. It is not denied that the latter expenditures were proper and were made in good faith, or that the money could not have been applied to dividends consistently with the duties of the Road. The Company now is more prosperous and proposes to pay dividends not only upon A but also on B and the common stock, but the plaintiffs say that it is not entitled to do so until it has paid to them unpaid preferential dividends for prior fiscal years in which it had net earnings that might have been applied to them but were not.

The obligations assumed by the Company appear in its instrument of incorporation and in the certificates of Preferred Stock A in substantially the same words "The holders of the Five Per Cent. Profit Sharing Preferred Stock A of the Company shall be entitled to receive preferential dividends in each fiscal year up to the amount of five per cent. before any dividends shall be paid upon any other stock of the Company, but such preferential dividends shall be non-cumulative." In the event of a liquidation the holders "shall be entitled to be paid in full out of the assets of the Company the par amount of their stock and all dividends thereon declared and unpaid before any amount shall be paid out of said assets to the holders of any other stock of the Company." By the plain meaning of the words the holders "are not entitled, of right, to dividends, payable out of the net profits accruing in any particular year, unless the directors of the Company formally declare, or ought to declare, a dividend payable out of such profits"; in the first instance at least a matter for the directors to determine. *New York, Lake Erie & Western R. R. Co.* v. *Nickals*, 119 U. S. 296, 307.

We believe that it has been the common understanding of lawyers and business men that in the case of non-cumulative stock entitled only to a dividend if declared out of annual profits, if those profits are justifiably applied by the directors to capital improvements and no dividend is declared within the year, the claim for that

year is gone and cannot be asserted at a later date. But recently doubts have been raised that seem to have affected the minds of the majority below. We suppose the ground for the doubts is the probability that the directors will be tempted to abuse their power, in the usual case of a corporation controlled by the holders of the common stock. Their interest would lead them to apply earnings to improvement of the capital rather than to make avoidable payments of dividends which they do not share. But whether the remedies available in case of such a breach of duty are adequate or not, and apart from the fact that the control of the Wabash seems to have been in Class A, the class to which the plaintiffs belong, the law, as remarked by the dissenting Judge below, "has long advised them that their rights depend upon the judgment of men subject to just that possible bias."

When a man buys stock instead of bonds he takes a greater risk in the business. No one suggests that he has a right to dividends if there are no net earnings. But the investment presupposes that the business is to go on, and therefore even if there are net earnings, the holder of stock, preferred as well as common, is entitled to have a dividend declared only out of such part of them as can be applied to dividends consistently with a wise administration of a going concern. When, as was the case here, the dividends in each fiscal year were declared to be non-cumulative and no net income could be so applied within the fiscal year referred to in the certificate, the right for that year was gone. If the right is extended further upon some conception of policy, it is enlarged beyond the meaning of the contract and the common and reasonable understanding of men.

Decree reversed.

A new copy.

Test:

Clerk, Supreme Court, U. S.